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Supreme Court of the United States

OCTOBER TERM, 1964

No. 352

GENERAL MOTORS CORPORATION, PETITIONER,

vs.

DISTRICT OF COLUMBIA.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 5, 1964
CERTIORARI GRANTED OCTOBER 26, 1964

SUPREME COURT OF THE UNITED STATES

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IN THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 17,017

DISTRICT OF COLUMBIA, Petitioner,

v.

GENERAL MOTORS CORPORATION, A Delaware Corporation, Respondent.

No. 17,018

DISTRICT OF COLUMBIA, Petitioner,

v.

GENERAL MOTORS CORPORATION, A Delaware Corporation, Respondent.

On Petition for Review of Decisions of the District of Columbia Tax Court

Joint Appendix—Filed August 15, 1962

[fol. 38]

BEFORE THE DISTRICT OF COLUMBIA TAX COURT

GENERAL MOTORS CORPORATION, A Delaware Corporation, Petitioner,

v.

DISTRICT OF COLUMBIA, Respondent.

Excerpts From Transcript of Proceedings—April 10, 1961

Washington, D.C.

The above-entitled matter came on for hearing at 10:15 o'clock a.m.

Before: The Honorable Jo V. Morgan.

ALEXANDER MILLS McPHERSON was called as a witness for the Petitioner and, having been first duly sworn, was examined and testified as follows:

The Court: Give your full name and address to the reporter, please.

The Witness: My full name is Alexander Mills McPherson. My address is 803 West Grand River, Howell, Michigan.

Direct examination.

By Mr. Barnes:

Q. By whom are you employed, Mr. McPherson?

A. General Motors Corporation.

Q. What is your position?

A. I am supervisor of state income and franchise taxes within the tax section of the corporation.

• • • • • • •

[fol. 38a] Mr. Barnes: In how many jurisdictions does General Motors Corporation have business establishments?

The Witness: In 38 states and the District of [fol. 38b] Columbia.

• • • • • • •

[fol. 38c] Q. Will you then describe in very broad terms where the Corporation operates, where is its headquarters, for example?

A. Well, I would say the principal headquarters of the corporation is in Detroit, Michigan; the principal executive officers are there. We also have an executive office in New York City, which in that instance the principal executives are financial executives.

Q. All right.

Now, where are the factories located?

Don't try to list them all, but some of them.

A. Well, the factories are principally located in the [fol. 38d] States of Michigan, Ohio, Illinois, Indiana, New York State, New Jersey, Delaware, Maryland, Missouri, California, and Georgia—I think those are the principal ones.

Q. Roughly, what proportion of the manufacturing activities, speaking of the factory activity, is in the State of Michigan, if you know?

. . . . . .

[fol. 38e] The Witness: Well, as to your question as to what manufacturing activities are carried on in Michigan, roughly speaking about fifty per cent of our physical properties, by that I am speaking of our real estate plants and equipment, and inventories are located there; in addition about fifty per cent of our payroll is there.

As far as the manufacture of vehicles goes, our Cadillacs are all manufactured in Detroit, Michigan; all the heavy trucks of GMC Truck and Coach Division are manufactured in Pontiac, Michigan.

In addition to that, there are many component parts manufactu there by the Parts Divisions.

In addi , there are manufacturing plants of Buick, Oldsmobile, and Pontiac in the State, too.

. . . . . .

[fol. 38f] Q. Mr. McPherson, you mentioned there was some manufacturing activity in Maryland. What does that consist of?

. . . . . .

The Witness: In Maryland, Chevrolet assembles automobiles in an assembly plant there which, as a matter of fact, are usually shipped to dealers in the District of Columbia.

By Mr. Barnes:

Q. Does the territory include only the District of Columbia?

A. No; it includes surrounding states, also.

Q. What manufacturing activity is carried on in Delaware?

. . . . . .

The Witness: In Delaware we have an assembly plant which assembles Buicks, Oldsmobiles and Pontiacs, which similar to the situation of Chevrolet in Maryland are

shipped both to District customers and in the surrounding area.

[fol. 38g] Mr. Barnes: • • •

Now, I invite the Court's attention to what is now marked Exhibit 3-C to the numbers stipulation.

We have copies—

The Court: That relates to the figures?

Mr. Barnes: Yes, sir, that is right.

By Mr. Barnes:

Q. Mr. McPherson, are there products manufactured in Michigan by General Motors Corporation which are shipped to customers in the District of Columbia, the receipts from which have been used in the numerator of this apportionment fraction?

A. Yes, there are.

Q. What, for instance?

A. Well, the shipments of Cadillac Motor Car Division represent cars assembled in Detroit, Michigan, and these figures for GMC Truck and Coach Division represent figures that were substantially produced, this would represent the heavy trucks, in Pontiac, Michigan.

Q. And the coaches?

A. And the coaches.

[fol. 38h] Q. Now, the products manufactured in Maryland which are shipped into the District of Columbia?

A. Those are the Chevrolet Motor Division figures shown here.

Q. And?

A. And the Buick Motor Division sales figures shown here and the Oldsmobile Division figures shown here, and the Pontiac Motor Division figures shown here represent cars assembled at the Wilmington, Delaware, plant, which were shipped to District dealers.

Q. Now, looking at the next to the last column, which is headed "Total Sales of Goods shipped from Stocks outside the District to Points within the District," the total of that column is $37,185,704.

Now, is that the figure which constituted the numerator of the apportionment fraction for 1957?

Mr. Wixon: I object, if your Honor please, this has all been agreed to. We have a stipulation here which I think covers this matter.

The Court: Why go into it Mr. Barnes, if that is so?

Mr. Wixon: At least I thought we had such a stipulation, your Honor.

Mr. Barnes: My point, your Honor, is simply to show of this $37 million almost all of this represents shipments [fol. 38i] from areas in which we have this overlapping tax arrangement.

The Court: Well, the witness has testified what shipments were made from other states. You merely asked him whether the $37 million figure was used in the formula as the—

Mr. Barnes: Very well; it was merely to tie it up.

Mr. Wixon: If your Honor please, on the questions and answers in respect of Exhibit 4-D, as I have it, I take it that is what the witness has.

Mr. Barnes: It is 3-C.

Mr. Wixon: It seems to me that the testimony was immaterial. It is covered by the stipulation. I would move to strike it on the ground of its immateriality.

Mr. Barnes: Your Honor, all that we have added is to identify certain shipments—

The Court: I did not hear Mr. Wixon's objection.

Mr. Wixon: As I mentioned to your Honor before, we have a stipulation here which covers the salient facts as far as I am aware of them in respect of the amounts involved, the returns, the records are in evidence in respect of the manner in which the tax was originally determined by the Finance Officer.

We have also covered in the stipulation, that there are [fol. 38j] no assembling or manufacturing operations performed in the District of Columbia.

This is, if not repetitive, immaterial too.

The Court: The witness has testified as to the origin or the state from which the various motor cars and trucks have come.

I take it that is not in the stipulation.

Mr. Wixon: It has been stipulated that all of the automobiles coming into the District of Columbia were not manufactured here and were not shipped from here.

The Court: That is correct, but his testimony is more in detail, it shows where the various automobiles and trucks were manufactured and from which point they came to the District of Columbia.

As to the figure of $37,185,704, I take it that that is covered in the stipulation, isn't it?

Mr. Barnes: It is, your Honor, I asked that question merely to relate it to the stipulation.

The Court: All right.

* * * * * * *

[fol. 38k] By Mr. Barnes:

Q. Mr. McPherson, will you tell the Court whether you personally had any negotiations with the Finance Officer in connection with those 1957 and '58 assessments?

A. Yes, I attended several conferences with officials of the Revenue Department discussing their proposition which was to assess additional tax against the Corporation.

* * * * * * *

The Court: I thought you were going to ask him what suggestions or what request was made, if any, in respect of adopting what in his opinion might have been a reasonable formula or some other formula that may have more aptly fitted the situation than the one they used.

Mr. Barnes: That's my next question. I will ask it now.

The Court: About whether he objected to it or not, what difference does it make? I must assume that he did because he wouldn't have been there.

Mr. Barnes: Very well, sir.

[fol. 38l] By Mr. Barnes:

Q. Mr. McPherson, did you present to the District Finance Office a proposed method of apportioning General Motors income to the District which differed from the one set forth in the returns and the one used as the basis for the assessment?

Mr. Wixon: Objection.

The Court: I will overrule the objection. Let's—I'm going to let him answer that and see what the next question is.

The Witness: Well, I would say we did not propose a specific numerically spelled-out different formula. However, we stated that we felt that the tax levy he had was out of all proportion to the business carried on in the District and we felt that the District formula basically was unfair because it didn't take into consideration other factors which are important for the production of income in the manufacturing business.

Specifically, we referred to other States which use both property and payroll in measuring income earned in the State as well as sales.

The Court: Well, what request, if any, did you make?

The Witness: Well, I would say this—well, to put it specifically, we made an offer in compromise.

The Court: I mean with respect to the formula.

Mr. Barnes: Your Honor, may I have that answer struck from the record because it's an improper answer, and I [fol. 38m] didn't want to ask him that.

Mr. Wixon: No, sir, I don't care to have it struck from the record. It's a statement he made. It was in response to your Honor's own question.

The Court: It wasn't responsive to it. I'm going to grant the motion to have it stricken.

The Witness: What was your last question?

Mr. Barnes: The Court's question.

The Court: Your answer to that question is stricken. I only asked him one question.

Mr. Barnes: Very well, I'm sorry, sir.

The Court: He didn't answer responsively and I struck the answer.

Mr. Wixon: You struck how much of the answer, sir? The compromise part, is that right, sir? So I will know what you are striking.

The Court: I struck the whole answer.

* * * * * * *

[fol. 38n] By Mr. Barnes:

Q. That question, Mr. McPherson, is, in the course of these negotiations which you had with the Finance Office, did you suggest any, or did other representatives in your presence suggest any principles upon which reasonable apportionment might be made?

* * * * * * *

[fol. 38o] The Witness: As I said in my previous statement, we suggested that other factors than sales should be used in properly measuring the income the Corporation earned in the District.

By Mr. Barnes:

Q. Did you mention any particular factors?

A. As stated in my previous statement, we did suggest that property and payroll should also be considered.

* * * * * * *

[fol. 39] WILLIAM A. PATON was called as a witness for the Petitioner and, having been first duly sworn, was examined and testified as follows:

The Court: Will you give your full name and address to the reporter and take a seat.

The Witness: My name is William A. Paton. My address is 2203 Hill Street, Ann Arbor, Michigan.

Direct examination.

By Mr. Barnes:

Q. Now Professor Paton, what is your occupation at the present time?

A. Well, I'm retired as far as the University of Michigan is concerned. I hold the title of Professor Emeritus of Accounting and of Economics at the University of Michigan.

* * * * * * *

I am currently doing some chores. I'm visiting professor of economics at Olivet College, teaching part-time and continuing a bit with my writing and some other fringe activities.

By Mr. Barnes:

Q. What's your educational background, Professor?

A. Well, my college education was at Michigan State Normal College, now called Eastern Michigan University, and the University of Michigan. My degrees, my earned [fol. 40] degrees, Bachelor's degree and Master's degree

and Doctor's degree were all granted at the University of Michigan.

The Court: In economics?

The Witness: In economics, yes, sir.

By Mr. Barnes:

Q. What was the subject of your specialty in your doctoral work?

A. The subject of my doctoral dissertation was accounting theory with special reference to the corporate form of organization. That, I might say, was completed and the degree granted in 1917.

Q. Has your activity since that time been largely related to that same field?

A. Yes, sir.

Q. Are you a certified public accountant?

A. Yes, sir.

Q. You referred to earned degrees as if there were a distinction. Have you received also some honorary degrees?

A. I have received one honorary degree, the Doctor of Letters from Lehigh University.

Q. What has been your professional career from the beginning?

A. Well, I have been primarily engaged in teaching at the University level. In fact, from 1914 to the date of my retirement from active teaching was on the staff, the active staff at the University of Michigan with some minor interruptions.

I was one year at the University of Minnesota, and a year in the summer school at the University of California; a year in the summer school at the University of Chicago; [fol. 41] and some other special lecture assignments and so on, but with those interruptions and a bit of an interruption in 1918 and 1919, I have been actively on the staff at the University of Michigan until the time of my retirement to emeritus status in 1959.

Q. When did you achieve or attain the rank of professor?

A. I was appointed a full professor in 1921.

Q. What have been the principal subjects of the teaching that you have done in this long period?

A. I have done some teaching of economics, but for the most part my teaching has been in the field of accounting with some stress, I might say, on accounting theory and accounting principles.

Q. Have you written any books?

A. Yes, that's a sort of disease that some people acquire. I have written roughly twenty or more books and monographs, some in collaboration with others and some entirely on my own.

Q. In what field were these books written?

A. Well, the majority of them were written in the field of accounting but I have done some writing that wasn't perhaps strictly in that field.

Q. Will you suggest some of the titles?

A. Well, the latest thing that I have been involved in is a monograph which I prepared with the collaboration of my colleague, R. L. Dixon, under the title "Make or Buy Decisions in Tooling for Mass Production." That monograph [fol. 42] was issued just this month by the Bureau of Business Research of the University of Michigan.

My latest major textbooks are "Asset Accounting," and "Corporation Accounts and Statements." In both cases with some assistance from my son, W. A. Paton, Jr.

There are numerous other books but I take it what you want is just an illustration.

Q. That is right.

Are you familiar with the book called "The Accountant's Handbook"?

A. Yes, sir.

Q. What is that thing and for what purpose is it used?

A. Well, the Accountant's Handbook, I think, is generally regarded as the bible, you might say, the standard reference book in the field of accounting.

Q. Did you have anything to do with its preparation?

A. Well, I prepared, as editor and chief contributor, the 1932 and 1943 editions.

Q. Have you written any magazine articles or professional journal articles?

A. Yes, I have written and published, oh, say, roughly a hundred technical articles for various publications.

Q. Do you belong to any professional societies?

A. Yes. I have been many years a member of the American Institute of Certified Public Accountants, the Michigan Association of Certified Public Accountants, the American Economic Association, and other professional groups and [fol. 43] organizations.

Q. Have you held any offices in those societies?

A. Yes, I did mention in the list I gave, the American Accounting Association, which is primarily the academic group, although there are some professional accountants included. I was president and held various other offices in that organization.

I have also been a member of the Council of American Institute of Certified Public Accountants, the Council of the Governing Body and I was for eleven years a member of the Committee on Accounting Procedures, so-called, of the American Institute of Certified Public Accountants.

* * * * * * *

The Court: Are you going to prove what formula was used or will it be conceded, Mr. Wixon?

Mr. Wixon: Yes, I will concede, your Honor, that the regulations promulgated by the Commissioners in August, 1953, were the regulations under which the District proceeded in this case.

* * * * * * *

[fol. 44] Tuesday, June 6, 1961

The above-entitled matter came on for hearing at 10:05 a.m.

Before: The Honorable Jo V. Morgan.

* * * * * * *

Whereupon, ALEXANDER MILLS MCPHERSON was called as a witness for the Petitioner and, having been previously duly sworn, was examined and testified further as follows:

* * * * * * *

[fol. 44a] Mr. McGratty: All right.

The next evidence which we propose to offer your Honor, if I may say so, is prompted by the following statement of the Court of Appeals in the Smoot case, and with your Honor's permission I would like to quote:

"Not only is there no express showing that the District [fol. 44b] has allocated to itself tax values beyond its jurisdiction but the view that it has done so seems greatly weakened by the fact that the Petitioner has never been required to pay any income or franchise taxes to the states of Maryland or Virginia. * * * Thus we are not here presented with a situation where the District is in competition with the other taxing jurisdictions for an apportionment of Petitioner's net income."

We now propose to offer proof to show that during the tax years in question this Petitioner in this case was required to pay and did in fact pay an income tax to the state of Delaware for the year 1958, an income tax to the state of Maryland for the years 1957 and 1958, and a business activities tax to the state of Michigan for the years 1957 and 1958; and that the District of Columbia is in fact in competition with these three taxing jurisdictions, among others, for apportionment of Petitioner's net income.

In each of these three years, if your Honor please—

The Court: You are stating what you expect to prove?

Mr. McGratty: Yes, your Honor. It is simply—

The Court: I understand. It is an opening statement.

Mr. McGratty: Yes, and I shall make it extremely brief.

In each of these three years, the District has in effect taxed the entire net income in respect of all products de- [fol. 44c] livered to customers residing within the District and our proof is designed to show that that portion of the income which is attributable to the property and payroll used to produce these products in the states of Delaware, Maryland, and Michigan, was in fact taxed by those three states. We refer specifically to those three states because the Buicks, Pontiacs and Oldsmobiles sold in the District were assembled at Petitioner's plant in Delaware. The Chevrolets sold in the District were assembled at Petitioner's plant in Maryland. And the Cadillacs and heavy duty G.M.C. trucks and coaches were manufactured in Michigan and various component parts of the Chevrolets, Buicks, Oldsmobiles, and Pontiacs were manufactured in Michigan.

[fol. 44d] Mr. McGratty: I only would like to add one further statement, that our proof in this connection will consist of the applicable tax statutes of those three states. The tax returns actually filed by Petitioner in those three—

The Court: You are really getting in detail. You explain to me what your theory is and I think—

OFFERS IN EVIDENCE

Mr. McGratty: —and the receipts.

I ask your Honor to take judicial notice of the Delaware Code Title 30, Part 2, Chapter 19, and particularly Sections 1902 and 1903, and I offer in evidence for the convenience of the Court an official copy of the statute to which I refer.

I offer that statute in evidence as Petitioner's Exhibit 8.

[fol. 44e] (The document referred to was marked Petitioner's Exhibit 8, for identification.)

The Court: Mr. Wixon, do you have any objection?

Mr. Wixon: Your Honor, take judicial notice of the—it is pretty apparent that this matter is not going to help you, it is not an authenticated copy, your Honor.

Mr. McGratty: Mr. Wixon is quite correct, it is not authenticated. We wrote to Delaware and asked for a certified copy. They gave us simply an uncertificated—excuse me, is this not a certification on the back of the statute, Mr. Wixon?

Mr. Wixon: I would say, sir, that this is simply a printed piece that bears no signature, no seal—

The Court: If I take judicial notice, I don't think I have to have anything today.

Mr. McGratty: It is not necessary, your Honor, but I offer it as a matter of judicial convenience.

The Court: I will receive it in evidence, Petitioner's Exhibit 8, only for that purpose.

(The document referred to, heretofore marked Petitioner's Exhibit 8 for identification, was received in evidence.)

Mr. McGratty: I offer in evidence as Petitioner's Exhibit [fol. 44f] 9 a duly certified copy of Petitioner's 1958 Delaware Corporation Income Tax Return.

The Court: Do you have any objection?

Mr. Wixon: I do, sir.

The Court: On what ground?

Mr. Wixon: On the ground that the Court of Appeals seems to feel, at least in its later expression, it is rather immaterial where the tax is paid other than in the District where of course the tax is emanated.

The Court: With all respect to the Court of Appeals I am certainly not going to decide a case like this on what they and—and not follow the Smoot case. I am not going to take that position. I am going to receive it in evidence and overrule your objection. They may say that the Smoot case was right. Who knows.

Mr. Wixon: I don't know for what purpose this is being offered.

The Court: It is to show as counsel has explained it and probably longer than he should have.

Mr. Wixon: I wasn't worried about his returns so much—

The Court: He wants to show that he was not only required to pay but he filed a return and I assume that he will follow that, that he paid the tax.

Mr. Wixon: Well, I take it your Honor is receiving it for [fol. 44g] the very limited purpose then of showing the filing of a return and the payment of some tax. I take it you are not assuming the accuracy of the material contained in that return.

The Court: No, no.

(The document referred to was marked Petitioner's Exhibit 9 for identification, and was received in evidence.)

Mr. McGratty: I offer in evidence as Petitioner's Exhibit 10 a receipt from the State of Delaware acknowledging payment of the Petitioner's 1958 tax return.

The Court: Mr. Wixon, any objection?

Mr. Wixon: I object to it, yes, sir. It is just a piece of paper bearing some sort of signature. You have got to prove that the man has some authority to execute it, say something about it.

The Court: Let me see it please, sir.

Mr. Wixon: For all we know it might have been refunded, sir.

Mr. McGratty: Your Honor will note that the figure mentioned in the receipt—

The Court: I will overrule the objection and receive it in evidence, Petitioner's Exhibit No. 10.

[fol. 44h] (The document referred to was marked Petitioner's Exhibit No. 10, for identification, and was received in evidence.)

• • • • • • • •

Q. Mr. McPherson, I hand you Petitioner's Exhibit 9 and Petitioner's Exhibit 11 for identification, and ask you to state what Petitioner's Exhibit 11-a, -b and -c (handing to the witness) is?

A. Petitioner's Exhibit 11-a, -b and -c is composed of three cancelled checks which represent the payment of our 1958 Delaware income tax.

Mr. McGratty: I offer in evidence Petitioner's Exhibit 11-a, -b and -c for identification.

Mr. Wixon: Objection, your Honor. The same ground I made with respect to the return of the like.

The Court: All right, I will overrule the objection and receive it as Petitioner's Exhibit 11.

[fol. 44i] (The document referred to was marked Petitioner's Exhibit 11-a, b and c, for identification, and was received in evidence.)

Mr. McGratty: I respectfully ask the Court to take judicial notice of the Maryland Annotated Code of 1957, Article 81 thereof and particularly refer to Sections 288(b) and 316, and for the convenience of the Court, I offer in evidence as Petitioner's Exhibit 12 a copy of the statute furnished to us by the Tax Department of the State of Maryland.

• • • • • • • •

[fol. 44j] Mr. McGratty: And I now offer as Petitioner's Exhibit 12 a duly certified copy of Petitioner's Maryland Income Tax Return for the year 1957.

The Court: Let's see what—Mr. Wixon?

Mr. Wixon: I object to it, sir, on the same basis.

The Court: With the same ruling I will receive it in evidence, Petitioner's Exhibit 12.

(The document referred to was marked Petitioner's Exhibit 12, for identification, and was received in evidence.)

Mr. McGratty: I offer in evidence as Petitioner's Exhibit 13 a certification by the Comptroller of the Treasury of the State of Maryland with respect to the payment by Petitioner of Petitioner's 1957 Maryland tax, which I have al- [fol. 44k] ready shown to Mr. Wixon.

Mr. Wixon: I object to it, sir.

The Court: Let me look at it.

I will overrule the objection. Receive in evidence Petitioner's Exhibit 13.

(The document referred to was marked Petitioner's Exhibit 13 for identification, and was received in evidence.)

By Mr. McGratty:

Q. Mr. McPherson, I hand you Petitioner's Exhibit—

Mr. McGratty: Will you please mark this as Petitioner's Exhibit 14-a and -b, for identification.

(The document referred to was marked Petitioner's Exhibit 14-a and -b, for identification.)

By Mr. McGratty:

Q. I hand you Petitioner's Exhibit 12 and Petitioner's Exhibit 14, for identification, and ask you to state what Petitioner's Exhibit 14 is?

A. Petitioner's Exhibit 14 is composed of two checks which represent payment of our 1957 Maryland income tax.

Mr. McGratty: I offer in evidence Petitioner's Exhibit 14.

Mr. Wixon: Objection, your Honor.

[fol. 44l] The Court: I will make the same ruling. We will receive it in evidence.

(The document referred to, heretofore marked Petitioner's Exhibit 14-a and -b for identification, was received in evidence.)

Mr. McGratty: I offer in evidence as Petitioner's Exhibit 15, a duly certified copy of Petitioner's 1958 Maryland Tax Return.

Mr. Wixon: Objection, your Honor.

The Court: I will overrule the objection and receive it in evidence, Petitioner's Exhibit 15.

(The document referred to was marked Petitioner's Exhibit 15, for identification, and was received in evidence.)

Mr. McGratty: I offer in evidence as Petitioner's Exhibit 16 a certification by the Comptroller of the Treasury of the State of Maryland with respect to the payment of Petitioner's 1958 Maryland tax.

Mr. Wixon: Objection, your Honor.

The Court: Same ruling.

Is that on the same form?

Mr. McGratty: Yes.

The Court: All right, I will receive in evidence Petitioner's Exhibit 16.

[fol. 41m] (The document referred to was marked Petitioner's Exhibit 16, for identification, and was received in evidence.)

Mr. McGratty: I ask that this be marked Petitioner's Exhibit 17-a and -b.

(The document referred to was marked Petitioner's Exhibit 17-a and -b, for identification.)

By Mr. McGratty:

Q. Mr. McPherson, I show you Petitioner's Exhibit 15 and Petitioner's Exhibit 17-a and -b for identification, and ask you to state what Petitioner's Exhibit 17-a and -b for identification is?

A. Petitioner's Exhibit 17-a and -b represents—well -a and -b each represent a check which between the two of them represent the payment of our Maryland Income Tax for the year 1958.

The Court: You mean together?

The Witness: Together they represent it.

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Mr. McGratty: I offer in evidence Petitioner's Exhibit [fol. 44n] 17, which the witness identified just prior to the recess.

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The Court: All right, I will receive it in evidence.

(The document referred to, heretofore marked Petitioner's Exhibit 17-a and -b for identification, was received in evidence.)

Mr. Wixon: Your Ho r may I say that my objection goes to that particular—

The Court: I understand, Mr, Wixon.

Mr. McGratty: I ask respectfully that your Honor take judicial notice of the compiled laws of the State of Michigan, 1948, Chapter 205, Act 150 of 1953 and particularly sections 205.552 and 205.553.

The Court: Very well.

Mr. McGratty: I offer in evidence as Petitioner's Exhibit 18 a duly certified copy of Petitioner's 1957 Michigan tax return.

Mr. Wixon: Objection.

The Court: Same ruling. Now it will be received in evidence as Petitioner's Exhibit 18.

[fol. 44o] (The document referred to was marked Petitioner's Exhibit 18, for identification, and was received in evidence.)

• • • • • • • •

Mr. McGratty: I offer in evidence as Petitioner's Exhibit 19, a duly certified copy of Petitioner's 1958 Michigan tax return.

Mr. Wixon: Objection, your Honor.

The Court: Same ruling. It will be received in evidence as Petitioner's Exhibit 19.

(The document referred to was marked Petitioner's Exhibit 19, for identification, and was received in evidence.)

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[fol. 44p] Mr. McGratty: I ask that this document be marked Petitioner's Exhibit 20a, b, c, and d for identification.

(The document referred to was marked Petitioner's Exhibit 20a-d for identification.)

Mr. McGratty: I ask that these documents be marked Petitioner's Exhibit 21a, b, c, d, e, and f for identification.

(The document referred to was marked Petitioner's Exhibit 21a-f for identification.)

By Mr. McGratty:

Q. Mr. McPherson, will you state what Petitioner's Exhibit 20a-d for identification consists of?

A. Petitioner's Exhibit 20a-d represents the payment of our 1957 Michigan income tax.

Q. Will you state what Petitioner's Exhibit 21a-f for identification consists of?

A. Petitioner's Exhibit 21a-f represents the payment of our 1958 Michigan income tax.

Mr. McGratty: I offer in evidence Petitioner's Exhibit 20a-d.

Mr. Wixon: You are offering them in evidence?

Mr. McGratty: Yes.

Mr. Wixon: I object.

The Court: I will receive them in evidence.

[fol. 44q] (Petitioner's Exhibit 20a-d was received in evidence.)

Mr. McGratty: I will offer in evidence the document which has heretofore been marked Petitioner's Exhibit 21a-f for identification.

Mr. Wixon: Same objection.

The Court: I will make the same ruling and receive them in evidence.

(Petitioner's Exhibit 21a-f was received in evidence.)

By Mr. McGratty:

Q. Mr. McPherson, was Petitioner's Exhibit 22 for identification prepared under your direction and supervision?

A. Yes, it was.

Q. Do the 29 states listed in this exhibit include all of the states in which General Motors Corporation does business—

• • • • • • •

(Continuing) —which imposed a state income tax or a tax based upon net income?

• • • • • • •

A. Yes, it does. This list, I might add, does not include the District of Columbia.

[fol. 45] Q. Are the basic statutes listed in the exhibits, the statutes which contain the provisions relating to such taxes?

• • • • • • •

[fol. 45a] Cross examination.

By Mr. Wixon:

Q. I have Petitioner's Exhibits 12, 15, 18, and 19, which I will hand to you, sir. Do any of those returns bear your signature?

A. No, sir.

Q. Whose signature is on those returns?

A. Officers of General Motors Corporation.

Q. And they are the officers who are authorized to file the returns on behalf of General Motors?

A. Yes, sir.

Q. And were you authorized to file those returns, sir?

A. I would rather state it this way: that under the law only certain officers must sign those returns and they have signed them.

[fol. 45b] Q. But you are not one of those officers?

A. No, sir.

Q. Do you have with you all of the records pertaining to the information which is reflected on those returns?

A. No, sir.

Q. It would be impossible, would it not, sir, to determine the meaning of those items without reflection back into the records of the General Motors Corporation?

A. No, I wouldn't say that. I think the meaning of the figures on the return are to a large degree self-evident.

Q. That means that you have a total which is given, a designation on the return; is that correct, sir?

A. Yes, under certain captions there are certain figures, yes, sir.

Q. I have Exhibit 19, which is in evidence, a return filed with the State of Michigan by General Motors, for 1958. I will pass that to you, sir.

It is rather illegible. I am having trouble looking at that one. I will get another one.

Well, I have Petitioner's Exhibit 15, a return filed with the State of Maryland for the calendar year 1958. You are familiar with that return, I believe, sir.

A. Yes, sir.

Q. I have opened the return to an unnumbered page which shows General Motors Corporation's 1958 taxable [fol. 45c] income is the heading on the sheet and it shows interest on corporate bonds, et cetera. As I read it, $40,523.68. Now how would I, Mr. McPherson, determine from you the meaning of that particular item?

A. In this manner: As you will note, down at the bottom here, it says "Taxable income as per U S corporate income tax return for calendar year 1958", which means that all of these various figures that come down to this taxable income are the same figures as appear on our federal income tax.

Q. Yes, but what makes up the $40,000, et cetera on that particular sheet of paper? What is the "et cetera"?

A. Presumably it is notes.

Q. Do you know what it is, sir?

A. I couldn't say at this point. I would not know positively.

Q. You would have to have the books and records of General Motors Corporation in order to make proper identification of those items, would you not, sir?

A. I retract my last statement. I think I can say positively that is interest on corporation bonds.

Q. All right, sir. Where are the records which reflect that amount as shown on that return?

A. In Detroit, Michigan.

Q. They are not here, sir, are they?

[fol. 45d] A. No, sir.

Q. Do you have any books or records supporting the material, documents of any kind which support the items shown on these several exhibits that I have mentioned to you—9, 12, 15, 18, and 19, I believe?

A. Are you referring to this $40,000 figure?

Q. Any of those returns, any books or documents or supporting material of any kind for any of the items shown on those several exhibits. Do you have any with you today?

A. Sir, I would like to point out—

Q. Do you have any books, supporting material, documents, or anything else with you today supporting those particular items?

The Court: Just answer the particular question, Yes or No.

The Witness: No.

By Mr. Wixon:

Q. Now, it is impossible, is it not, sir, for you or for anyone else in this courtroom to give any explanation of these items or to provide the support for them without the books and records of the corporation; is that not true, sir?

A. Well, I should say this: that if you are actually going to support every single figure—

The Court: No, he asked you a question—

[fol. 45e] Mr. Wixon: I think you understand me, sir.

Would you read it back, Mr. Reporter, please?

(The reporter read the question.)

The Witness: I can give a general explanation of them. I cannot produce here all the supporting data.

By Mr. Wixon:

Q. You don't have it with you, do you, sir?

A. That is right, I do not, and I would need a railroad train to have it.

Q. These are your exhibits, sir, not mine.

The Court: Interrogate the witness. Don't make a statement.

MOTION TO STRIKE CERTAIN DOCUMENTS AND DENIAL THEREOF

Mr. Wixon: If your Honor please, without carrying this on, it has been testified that there are no books, records, or other materials for this particular docu nt. Your Honor has admitted them in evidence. Having admitted them in evidence, they are in there for all purposes and thus I now move that your Honor strike these documents for the reason that I am precluded completely from any cross-examination on the figures on items or amounts shown in these returns for the simple reason there is nothing here supporting these documents, nothing that I may look at, that it would be idle for me to carry this out and to prolong it and to ask this gentleman where gross sales in the amount of $9,461,855,-874.12 came from on the 1957 return for the State of Mary-[fol. 45f] land for the General Motors Corporation.

The Court: Overruled.

Mr. Wixon: I now ask your Honor that this case be proceeded, of course, as far as it can today, but that General Motors Corporation by your Honor's direction make available all books and records of the corporation supporting these documents so that I may have opportunity to examine them and to make the necessary inquiries about them and to examine a witness upon them.

The Court: The motion is denied.

Mr. Wixon: And I would like to ask your Honor one further question.

As I said, my understanding is that your Honor has admitted these tax returns in evidence without qualification. I would like to have an understanding, if your Honor please, as to the basis of the returns in evidence and the effect of them in evidence.

The Court: Mr. Wixon, you didn't listen to the opening statement of counsel or the purpose for which they were introduced. They were introduced merely to show that the income tax or taxes were based on income were paid to several states and you yourself specifically had the Court rule

that they were not to be taken as to prove anything pertaining in the returns.

Mr. Wixon: But they have to prove, sir, the fact that [fol. 45g] income taxes were paid to the states, but your Honor's own expression—and how much and what—

The Court: I made my ruling. I am going to deny your motion. They are in there for a very limited purpose.

* * * * * * *

[fol. 45h] Thereupon, WILLIAM A. PATON was recalled as a witness for the Petitioner and, having been previously duly sworn, was examined and testified as follows:

* * * * * * *

Q. Professor Paton, will you state to what from an accounting standpoint the income of a manufacturing corporation is attributable?

* * * * * * *

The Witness: In my opinion, the income of a manufacturing corporation is brought about by and attributable to the entire (buyer) process of production, including—

The Court: Cost of production?

The Witness: Yes, including the preliminary plans, the actual manufacturing process, and the marketing of the finished product.

Q. How does an accountant undertake to recognize the significance of the various factors utilized in the cost of the productive process?

* * * * * * *

The Witness: Well, the accountant recognizes the significance of the factors utilized in production by ascertain- [fol. 46] ing and recording the cost of these factors, speaking broadly, as these costs are incurred.

By Mr. McGratty:

Q. What elements are included in cost?

A. Well, I am using the word cost to include all of the expenses involved in the process of turning out and marketing the product of the enterprise. Now these costs are sometimes described in terms of departments or stages of

production such as preliminary engineering and design, the actual process of fabrication, the process or departments of shipping and selling, and general administrative activities.

The Court: Advertisements.

The Witness: Yes.

The Court: Public relations.

The Witness: I use the word cost very broadly here to include all of these operating charges in a broad sense.

Now, I might explain a little more specifically by referring to what we sometimes call a classification of costs in kind; that is, these costs include all of the wages and salaries paid to all of the employees of all of the different grades and types. They include the expenditure for materials and supplies of all the different kinds. They include the using up of plant capacity that we ordinarily refer to as depreciation. They include the cost of utility services such as power that may be acquired by the company, the [fol. 47] cost of maintenance, insurance, property taxes, advertising, your Honor mentioned, the entire range of expenses that are incurred in the entire range of production, using the word production to cover everything from the initial planning stages through to the making of the product.

By Mr. McGratty:

Q. Now, would you tell us how from the standpoint of accounting the net income of a manufacturing corporation is determined as an accounting matter?

* * * * * * * *

The Witness: Just speaking very briefly, the accounting process, I think as we all recognize, is a process of comparing the revenues of a particular period of time as represented by the value of the product delivered during that period of time with the total cost and charges applicable to that revenue measurement and net income emerges when the value of the product sold at the selling price exceeds this entire package of cost applicable to that mass of revenue.

By Mr. McGratty:

Q. From an accounting standpoint, is there any relationship between the cost of the various productive factors employed such as engineering cost, manufacturing costs, marketing costs, and the proportion of total net income attributable to each of the factors employed in production?

[fol. 48] A. Yes, in my judgment there is. The income is the resultant of combining an array of productive factors in the form of a finished product, and the amount attributable reasonably to that income to any particular factor is represented by the cost of that factor as numerator to the total cost of all of the factors, is the denominator.

In other words, it is related by the proportion of the cost of the particular factor to the total cost of all of the factors involved.

Q. In your opinion, sir, is there any other method available for the determination of the proportion of net income attributable to each of the various factors employed?

A. No, sir, in my opinion this is the only available procedure. There is no alternative procedure that can be utilized for that purpose.

Q. Now, Professor Paton, by the way of illustration, will you please assume that the cost of producing and marketing an automobile is $2,000.

* * * * * * *

By Mr. McGratty:

Q. Will you assume that the selling price of that automobile is $2,200 and that the resulting net income or profit is $200. Now, will you assume that costs are incurred by major departments as follows: $200 cost incurred by the engineering department for research, design, tooling, and so forth; assume that $1,440 of costs are incurred by the [fol. 49] manufacturing department for employee services, materials, and supplies, for maintenance, insurance, depreciation, and so forth; assume further that $160 of costs are incurred by the sales or marketing department; assume finally that $200 of costs are incurred for general administration activities and other general overhead items, giving you total costs of $2,000.

Now, on the basis of these assumptions, is it possible to determine the amount of net income fairly attributable to each of the four departments which I have listed?

A. Yes, I would say that it is. On the basis of the assumed data, in the case of the engineering department, the costs incurred in that department under the assumptions of $200 is 10 percent of the total cost incurred of $2,000. Accordingly, I would say that we can reasonably attribute to that department 10 percent of the net income a sum of $200, namely, $20.

The manufacturing costs assumed is $1,440 and is 72 percent of $2,200 and 72 percent of $200 is $144. Under these assumptions accordingly the manufacturing department—let me put it this way, one might say that $144 of this net result from combining these factors can be attributed to the manufacturing activity. The sales activity, selling and marketing and shipping probably included there is assumed at $160. That is 8 per cent of the—wait a minute—yes, 8 per [fol. 50] cent of the total cost of the $2,000 and accordingly 8 per cent of the net earnings of $200 may be, or $16, may be reasonably attributed to that activity.

The general administrative functions and so on are assumed to, under the data you have given me, assumed to total $200, which is 10 per cent of the total assumed costs of $2,000 and accordingly 10 per cent of the $200 net income resulting from combining these factors in the finished product can be attributed to those functions.

Now those two figures I believe total up to $200 of net income.

Q. Is it possible, sir, to determine the amount of net income earned by a corporation in a particular geographical or political area?

A. Yes, I think that it is. In order to do so it is necessary to find out where the costs are incurred that represent the efforts that taken together in a package are responsible for the earnings of the company.

For example, to take this very case, let's—if I might add an assumption to your assumptions, I suppose that the $200 of—that the engineering activity happens to be located entirely in the State of Michigan, my home state, and all of the other activities happen to be located somewhere else.

In that situation we would say that all of the earnings attributable to engineering, which is as I explained a moment ago I would determine as being 10 per cent of the net earnings, can be attributed to that geographic area, in a geographic assignment.

[fol. 51] Q. Now suppose, sir, that instead of all of the engineering activities being conducted in the State of Michigan, one-half of the engineering activities were conducted in the State of Michigan and the other half in the State of Ohio. How then would you apportion income attributable to the engineering department?

A. Well, assuming that we mean by one-half one-half of the cost incurred—

Q. Yes, sir.

A. —then we have got $100 of engineering cost incurred in Michigan under that assumption and $100 of engineering costs incurred in Ohio, so on the basis of those cost figures, one-half of the total fraction of net income attributable to engineering would be assigned geographically to Ohio and one-half would be assigned geographically to Michigan.

Q. I see.

Sir, is the assignment of income on a geographic basis as you have described it, in terms of the productive activities, carried on in various areas and the costs of these activities, is that affected in any way, in your opinion, by the location of the customers of the manufacturer?

A. Well, in my judgment it is affected not by the location of the customer as such at all, but if any of the selling costs are incurred because of the customer's location, then to that extent the customer's location may affect the situation. What we have got to remember is that the, the [fol. 52] essence of my conclusion here on the accounting processes, is that we have got to find out in a geographical assignment, we have got to find out where these costs are incurred. We have got to make up our minds about that, and in my opinion—

The Court: Do I understand you don't consider whether or not there is any waste or whether there was any profit or—

The Witness: I realize, your Honor, this that there can be arguments about whether particular costs were properly incurred and so on for purposes of my generalization I am assuming reasonably effective operations and that we are incurring costs in accordance with plan and with the location of our efforts and so forth.

But I wouldn't be one of those who would say that there is no room for debate on the appropriateness of a particular cost and in a particular location. But the essential point that I am trying to make is that I can consider the costs. The question to me is not where the customer is located but where are the costs incurred.

Now the customer's location may affect those costs particularly in the marketing area, but that is incidental, for instance, if the customer moves from one state to another it might not affect the location of our efforts at all.

* * * * * * *

[fol. 53] By Mr. McGratty:

Q. Professor Paton, would you please summarize the underlying reasons for the opinion you have expressed with respect to the factors to be considered in undertaking to attribute to find the income of a manufacturing corporation?

A. The propositions that I have been trying to emphasize here are very simple. The first one is that as I see it and I would be surprised to find there was any general disagreement on this, among accountants certainly, the income is a resultant of and attributable to the entire package of efforts which I have referred to as a productive process, using the phrase broadly.

Now income is an economic measure. It is a measure in dollars. If we are going to attribute the resultant income to the particular factors of production we have got to find an economic measure there. The only one that I can see is available is that of relative costs. What is the cost of this department or this effort as compared to the total costs? Then when it comes to geographical assignment, the secondary step, that is a case of deciding where the costs are incurred. Where is this effort made by this particular company in (or) particular period (pair).

I might add, if the Court permits, that I have always been very skeptical of working out anything of this kind except on what I would call a rather cold-blooded impersonal figure of costs. I can understand how an engineer, [fol. 54] or an engineer staff that has been designing a car, for instance, may feel that they really are the folks that produce the income.

The Court: You realize that the salesman is the one who sells the car.

The Witness: I was going to add that very thing. And the manufacturing people may become rather enamored of what they are doing, but I think that these rather subjective reactions can't be taken too seriously when we are really up against the cold-blooded problem of assigning results to particular productive factors and trying to find out where the locations are.

The Court: This is your view in accounting?

The Witness: Yes.

* * * * * * *

Direct examination (resumed).

By Mr. McGratty:

Q. Professor Paton, I am going to ask you to assume the following facts: General Motors Corporation is engaged primarily in the manufacture and sale of automobiles, trucks and other motor (automotive) vehicles, parts and accessories therefor, and engines. General Motors does not have any plant and does not conduct any manufacturing or assembly operations within the District of Columbia. General Motors does engage in regular and systematic promotion and selling and liaison activities with [fol. 55] customers in the District of Columbia through offices located in the District and through traveling employees who come, from time to time, into the District of Columbia.

During the year 1957, General Motors sales to residents of the District of Columbia, to whom shipments were made within the District, amounted to approximately 393/1000ths of 1 per cent of its total sales, the District sales amounting to $37,185,704 and total sales amounting to $9,461,855,874.

During the year 1958 the percentage was approximately 414/1000ths of 1 per cent of total sales, the District sales amounting to $32,542,519, and total sales amounting to $7,853,393,381.

During the year 1957, the compensation paid by General Motors to employees assigned to its offices in the District of Columbia amounted to approximately 45/1000ths of 1 per cent of the total compensation paid to all employees, the District payroll amounting to $1,203,081 and the total payroll amounting to $2,662,072,037.

During the year 1958, the percentage was approximately 49/1000ths of 1 per cent of total payroll, the District payroll amounting to $1,158,093 and the total payroll amounting to $2,354,049,741.

During the year 1957 the average gross value of the real and tangible personal property used by General Motors in the District of Columbia amounted to approximately 22/1000ths of 1 per cent of the total gross value of all the [fol. 56] real and tangible personal property used by General Motors, the value of the District of Columbia property amounting to $1,360,676, and the total value of all the real and tangible property everywhere amounted to $6,247,160,370. These amounts represent the sum of (a) the gross book values of owned property based upon cost, except that inventories are valued at the lower of cost or market, and, (b) the values of rented property taken at eight times the rent paid during 1957.

During the year 1958 the percentage was approximately 21/1000ths of 1 per cent, the District property value amounting to $1,326,209, the total property value everywhere amounting to $6,403,673,576.

The District of Columbia income and franchise tax of 1947, as amended and in effect during the years 1957 and 1958, provided for a franchise tax at the rate of 5 per cent upon every corporation and unincorporated business for the privilege of carrying on or engaging in any trade or business within the District, and further provided that the measure of the franchise tax shall be that portion of the net income of the corporation and unincorporated business as is fairly attributable to any trade or business carried

on or engaged in within the District and such other net income as is derived from sources within the District.

[fol. 57] General Motors' total net income required to be apportioned was $1,312,092,839 in 1957, and $653,396,893 in 1958. In each year the District of Columbia determined the portion of total net income attributable to the business carried on by General Motors within the District by multiplying total net income by a fraction representing a single factor sales formula. The numerator of the fraction was the amount of sales of all products made to District residents and shipped to them in the year from points outside the District during the year. The denominator of the fraction was the amount of all sales made everywhere. As I already stated, District sales amounted to 393/1000ths of 1 per cent of total sales in 1957, and the District attributed $5,156,525 or approximately 393/1000ths of 1 per cent of General Motors' total net income in 1957 to General Motors' business within the District.

District sales amounted to approximately 414/1000ths of 1 per cent of total sales in 1958, and the District attributed $2,707,677 or approximately 414/1000ths of 1 per cent of General Motors' total net income in 1958 to General Motors' business within the District.

Now, let me point out, parenthetically, for your convenience, I suggest you may refer, to the extent you deem desirable, to Plaintiff's Exhibit 7a for identification which contains each of the figures which I have mentioned during the course of this question.

[fol. 58] Now, Professor Paton, on the basis of all of the foregoing facts, which I have asked you to assume, do you have an opinion as to whether the method of apportionment used by the District of Columbia, as applied to General Motors Corporation, resulted in a reasonable approximation of the net income fairly attributable to the business carried on by General Motors within the District of Columbia during the years 1957 and 1958?

Mr. Wixon: If Your Honor please, I would like to impose an objection. I don't think some of these items are in the record.

. . . . . .

Mr. McGratty: That is why I raise the question at this point.

I respectfully ask your Honor at this time to rule on the admission in evidence of the facts stipulated in paragraphs 9 and 10 of the stipulation.

* * * * * * * * *

The Court: What does the respondent say? They concede the fact, but deny its admissibility?

* * * * * * * * *

Mr. Wixon, you object, don't you?

Mr. Wixon: I do. But I would like to point out one more thing to your Honor. It has to be read in its full context, [fol. 59] I believe. We state that we have included the dollar amounts in paragraphs 9 and 10 in order that strict and formal proof on those amounts shall not be required; but by agreeing to the inclusion of dollar amounts in paragraphs 9 and 10, we did not stipulate or concede that these amounts, or the basis—and I would like to emphasize the words "or the basis"—upon which those amounts are predicated, are pertinent, relevant or material.

Now we don't concede the manner of arriving at these dollar amounts, the basis, in other words, unless, of course, your Honor disagrees; and we do not concede materiality and relevancy. But what we say, in effect, is that if your Honor proposes to let these dollar amounts as shown in paragraphs 9 and 10 into evidence, then we will agree that the calculations were correctly made.

For example, your Honor, may I point to paragraph 9 on page 8, where we have a statement as to property figures. They are set forth on page 9. We have an explanation of the method of computation of those figures. I shan't take up your Honor's time by reading what is right before your Honor. We make no concession that the methods of calculation are correct, but I said once before if your Honor holds that the methods of computation are pertinent, relevant, material, and may be admitted into evidence, and all that sort of thing, then we agree that the results of applying the method was correctly reached and that the dollar

amounts reflect that method. Thereafter, of course, it becomes a matter simply of mathematical computation. [fol. 60] The Court: Over your objection, I am going to consider and receive these stipulations as correct, and if the question just propounded, the hypothetical question, is based upon the evidence in these paragraphs and the other record, I am going to admit it.

* * * * * * *

By Mr. McGratty:

Q. Professor Paton, out of an abundance of caution, let me ask you now to re-read to yourself paragraphs 9 and 10 of the supplemental stipulation, which is Petitioner's Exhibit 6, so that you may have clearly in mind the precise manner in which each of the figures used in my hypothetical question to you was calculated.

* * * * * * *

By Mr. McGratty:

Q. Now on the basis of the facts which I have asked you to assume, including the facts set forth in paragraphs 9 and 10 of Petitioner's Exhibit 6, I ask you: Do you have an opinion as to whether the method of apportionment used by the District of Columbia as applied to General Motors Corporation resulted in a reasonable approximation of the net income fairly attributable to the business carried on by General Motors within the District of Columbia during the years 1957 and 1958?

[fol. 61] Mr. Wixon: Now, if your Honor please, I would like to interpose another objection. This gentleman has testified, as I understand it, as an accountant. An accountant is one skilled in the knowledge and science of keeping accounts or records or books. I don't think this gentleman is qualified to express himself upon whether he thinks that we in using a certain t[illegible] of approach to taxation caused a result of a fairly attributable determination of income in the District of Columbia.

Moreover, it is a question of law. It is a matter upon which your Honor and the Court of Appeals have spoken on any number of occasions, not a matter of accounting.

The Court: Not a matter of economics.

Mr. Wixon: Not a matter of economics. It is a matter, I think, of law, because if it is fairly attributable, it is fairly attributable under a statute but not fairly attributable from a standpoint of accounting.

The Court: I am inclined to agree with you about the accounting, but I think it is a matter of economics.

Mr. McGratty: I suggest to your Honor it is a matter both of economics and of accounting.

The Court: Why? What has accounting to do with it? Nothing magical about accounting.

Mr. McGratty: Fairly attributable, as a matter of fact, from the standpoint of a factual attribution in the expert [fol. 62] opinion of one skilled in the art of accounting, sir.

The Court: Professor Paton is an expert in accounting. He is not an expert in economics.

Mr. McGratty: It so happens that Professor Paton is qualified as an economist as well as an accountant, sir.

* * * * * * *

By Mr. McGratty:

Q. Professor Paton, leaving aside at this moment your qualifications in the field of accounting, would you tell us what, if any, training you had in the educational circles in the field of economics?

A. My training at the graduate level was almost entirely in the field of economics, economic theory. It is true that my doctorate dissertation had a bent toward the accounting field in which I was beginning to take an interest at that early date. I held a professorship of economics at the University of Michigan—

The Court: How long?

The Witness: I was made full professor in 1921, and I became professor emeritus in 1959. I was a full-fledged member of the department of economics and at least by my colleagues was recognized as an economist as well as an accountant. Now, that may seem—

The Court: Were you a professor in economics from 1921 until—

[fol. 63] The Witness: Yes, I am a professor emeritus of economics now.

The Court: Do you do any work in that field now?

The Witness: I have done some work in it almost all the time. I don't want to make any pretentions here that are the least bit exaggerated. I believe I am listed in Who's Who as an economist and accountant. I believe that is the way it has been listed.

I have been a member of American Economic Association since 1917. I have gone to a great many meetings and have been recognized as knowing something about economics and have participated in programs once or twice.

But it is true, as I said here the other day or some time back, the emphasis in my work has been on accounting for years. But I have nevertheless been a full-fledged, active member in the department of economics at the University of Michigan.

I have kept up my reading, and I have done a little writing in the field. In 1952 I wrote one book that has perhaps a kind of light title, "Shirt-Sleeve Economics," a 460-page book, that wasn't badly received and is entirely in the field of economics.

The Court: When you were a professor from 1921 to 1959, to what extent did you teach economics?

[fol. 64] The Witness: There was one course that I taught down through the years that was labeled "Determination of Income" that we always considered sort of a combined course. The graduate students in economics as well as graduate students in some of the applied lines would take this course. And that was the extent of my formal teaching that could be said to be in economics. This course was listed in the economics department and was considered sort of a combination.

I might add this, that we don't draw perhaps as rigid lines as maybe we should. Some phases of accounting analysis are regarded by most of my colleagues as within the field of economics in a broad sense of the word. But I spoke, I think, with complete accuracy previously when I said the emphasis in my work, since 1920 certainly, or 1921, has been more in the accounting field that in pure eco-

nomics, but I have been a straddler. Maybe that is a confession of weakness, but I have been straddling, sir, the two fields right down to date.

The Court: Mr. Wixon, do you want to examine? Do you have any questions?

Voir dire examination.

By Mr. Wixon:

Q. Professor Paton, would you say the major part of your activities have been devoted to accounting?

[fol. 65] A. I think that is a fair statement of it. It is true that a good deal of the consulting and testifying I have done down through the years has been in areas that I would regard as just about as much economics as accounting, but the emphasis has been in the field of accounting and I am probably better known in that area than anywhere else.

Occasionally somebody makes the mistake of calling me "Mr. Accounting", but I have—and this is a very sincere statement, sir—I have retained an active interest in economics right down through the years. I probably am as faithful a reader of American Economics Review, our principal journal in this country, as any member of the American Economic Association, and have tried to keep posted in the field of economics.

As I say, I don't draw as sharp a distinction between accounting in a broad theory sense and economic theory as perhaps some people would.

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Mr. McGratty: If your Honor please, the question thus far simply asked whether professor Paton did have an opinion.

The Witness: Yes, on the basis of the data in your lengthy question or assumption of facts, I do have an opinion.

By Mr. McGatty:

Q. Now, let me ask you, in your opinion, did the method of apportionment used in the District of Columbia achieve a reasonable approximation of the net income fairly attrib-

[fol. 66] utable to the business carried on by General Motors within the District during the years 1957 and 1958?

* * * * * * *

A. No, in my opinion it did not.

Q. Now may I ask you to state the reasons for your opinion, sir?

A. My understanding is that the procedure followed by the District assessor is that he assigns income to the District on the basis of sales delivered in the District to total sales, and the thing that I have been keeping track of is the percentages. The percentage used, as I understand it, in 1957 was .393 per cent, approximately, and the percentage used in 1958 was .414 percent.

Now, the trouble with the application of these percentages to this particularization and the thing that gives me a firm conclusion that results not in an assignment that is fairly attributable are the facts that if you take payroll, for instance, into consideration, and payroll is a very important cost, it permeates the entire array of departments and activities, it permeates the sales activity fairly heavily, when you include the wages and salaries of all types of employees. And if I have the thing correctly in mind, the percentage of payroll in the District was roughly .045 in 1957 and .049 in 1958. Now the percentage used by the [fol. 67] assessor is between eight and nine times that payroll percentage.

Now, if we turn to the other major part of the coin, capital, basically, I regard income as generated by capital and services. If we turn to the other side of the coin and take property as a—

The Court: Incidentally, that is the definition of income in the regulations of the District; it is that derived from capital and services.

The Witness: When you get down to brass tacks, that is pretty good, when you get right down to the root of things, and when you turn to the measure of capital, that is based upon property in the District and property out, we find, including rental property, and I assume no responsibility for any computation, any methods of determining the value, but here we find that the percentage used by the District in 1957 is about eighteen times the percentage

that you would arrive at by relative property locations and in 1958 is almost exactly twenty times.

Now, to me that is a prima facie evidence that there is something inherently unreasonable about the procedure as applied in this case, because payoll is an excellent rough guide with respect to services and property is not bad, as a rough guide to the application of funds in particular areas, so to me, in this particular situation, the calculations used, as I understand it, by the assessor, are I think seriously unreasonable.

[fol. 68] By Mr. McGratty:

Q. Professor Paton, in your opinion, and on the basis of the same facts—

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By Mr. McGratty:

Q. (Continuing) —relative to General Motors, which I have previously asked you to assume, could that portion of the net income of General Motors fairly attributable to the District of Columbia be determined by the use of the property factor alone?

A. No, I don't think so. It's not adequate by itself.

* * * * * * *

Q. What would your opinion be with respect to the use of a payroll factor alone?

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The Witness: As I have already said, the payroll is a very important expression of the way in which the cost of services permeates the activity of an enterprise. By itself it is unsatisfactory, because it ignores the capital factor.

Q. What would be your opinion with respect to the use of both a payroll factor and a property factor?

A. Well, in my opinion, a combined combination of payroll relationships and property relationships would make a pretty good rule of thumb. It is not ideal, but payroll does describe the service situation, personal services.

[fol. 69] The Court: And doing that you are leaving out sales?

The Witness: No, I had no intention, because payroll permeates the selling activity and so does property. I am resting my proposition again on the basic economist view, you might say, that capital and labor combined in various ways in various situations are responsible for the income result that finally develops from enterprise's activities.

The Court: You don't think sales produces any income?

The Witness: The sale as such doesn't, but the selling activity—

The Court: Don't you think the sale itself does?

The Witness: No.

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The Witness: I do want to make it plain that I do think that the selling effort and the market activity and all that sort of thing, that is one of the important branches of the efforts and activities of a great many enterprises. It is, as I see it, the activities with the enterprise we are looking at in combining the factors of production throughout a series of stages, planning, manufacturing, and selling.

The Court: Suppose you bought a house for $10,000 and kept it for "X" number of months and sold it for $20,000. Don't you think the sale would produce income?

The Witness: Well, I would put it this way:—

[fol. 70] The Court: You don't think the selling activities—

The Witness: You realize income through the sale, but the customer does not create your income.

The Court: Nobody said they did. But don't you think the sale produces income?

The Witness: No.

The Court: It results in income, doesn't it?

The Witness: I am not trying to quibble, your Honor, but I think we have a point here of quite a little bit of importance.

As I see the situation, when we are talking about the income of a particular enterprise, it is the efforts of that enterprise that produces the income. If there weren't any customers there wouldn't be any income.

The Court: Of course not; no income earned.

The Witness: We say it is earned by the entire process of production, but we don't usually record it.

The Court: You don't get it; none of it.

The Witness: You don't get the c sh until you deliver the product.

The Court: Let me ask you a question. It will be segments now.

Let's take a segment of a carload of automobiles. They leave their plant and come down on, say, the Pennsylvania Turnpike, and they have a wreck. No income, is there? [fol. 71] They are destroyed. Is there any income?

The Witness: No, not with respect to that particular event.

The Court: Of course not. No income is earned until they get to Washington and they are sold.

The Witness: No. I cannot agree with that at all. I beg your pardon, sir, but I consider that is a fundamental error.

The Court: Let's suppose they are delivered and the person who is supposed to pay for them doesn't pay for them. No income is earned, is there?

The Witness: Income was earned, but due to bad credit situation you finally didn't collect it.

The Court: There is no income.

The Witness: Let me use a simple analogy. I think there is a little point here you and I can get together on.

The Court: We won't get together on that, I'll tell you.

The Witness: Wait a minute. I think there is a little point. It is a very interesting point.

Let's say we are growing apples, or something of that kind. That takes me back to my farm days; I don't know whether it is a good example. But the income that may be produced by disposing of the apples, in my opinion, and I assumed that was pretty widely shared, is attribu- [fol. 72] table to the entire process.

The Court: We are not talking about things attributable.

The law says this, the law says that if the parties are engaged in business, you have got to apportion that income. It doesn't make any difference where it is earned. We are dealing with that situation.

But I am just talking about a matter of theory, that you are talking about there is no income earned in sales. I think you are wrong.

The Witness: I didn't say there was no income earned by this salesman.

The Court: I didn't say salesman; I said sales.

The Witness: I don't think that we can support soundly the theory that the customer creates the income. The income is created by the entire process of production which culminates in the sale; that is true.

The Court: It is academic, because the law requires that parties engaged in business in the District, there must be apportionment, or should be, anyhow.

Go ahead. I am sorry I have interrupted.

Mr. McGratty: That is all right, your Honor. We welcome any questions from the Bench.

By Mr. McGratty:

Q. Would you state your opinion, Professor Paton, with respect to the use of a three-factor formula based upon payroll, property and sales?

[fol. 73] A. If I might insert something there, ideally I think the determination should be made along the line that we were talking about in your earlier hypothetical question on the basis of the relationship where costs are incurred.

Now it seems to me that when you have a formula based on payroll, it is very important in basic cross section of costs, that permeates selling activity and everything else, plus the use of the relationship of property in a particular state or territory or area, as compared to property everywhere, that we don't improve the situation by putting in relative sales as a third factor.

For one thing, there is considerable duplication then because in my payroll—I say "my" payroll—in the payroll assignment you include a very important part of the selling activity, namely, the compenation paid everybody connected with the selling activity. So it seems to me—

The Court: Also includes a good deal of manufacturing, too.

The Witness: It seems to me that we muddy the waters to some extent. That is my personal opinion. I don't want to suggest that I think there is anything terribly wrong, your Honor, with the three-factor formula; I am just sug-

gesting that, to me, the cost approach is the only one that I can see that is sound and usable in all cases.

Now, I appreciate the difficulties of working it out in any [fol. 74] fine-spun fashion. I appreciate the need for perhaps practical methods of approximating this desired fair assignment. That is what everybody, I assume, wants and is under the statute at any rate, within the limits of any statute, the fair, equitable assignment.

The Court: Have you finished?

We will have a recess for five minutes.

By Mr. McGratty:

Q. Professor Paton, in your opinion, when a property factor is employed, is a more accurate result or a less accurate result obtained by using gross property value; that is, original cost without regard to depreciation which has already occurred or by using net book value after depreciation?

A. I prefer the gross property approach largely because it is my impression that the costs, like depreciation, maintenance, insurance, and what-not, peculiarly associated with property, tend in general to be somewhat more in proportion to gross than to net.

That is a matter of personal opinion on my general experience.

[fol. 75] By Mr. McGratty:

Q. In your opinion, are the views which you have expressed during the course of your testimony in accordance with generally accepted principles of accounting?

Mr. McGratty: Yes, your Honor.

The Witness: In my judgment the positions I have taken are in accord with generally accepted accounting principles.

Cross-examination.

By Mr. Wixon:

Q. Professor Paton, as I gathered from your testimony, you place major emphasis upon costs; am I correct, sir?

A. Yes. I think that is a fair statement; that is, the incurring of costs is the thing that I stressed in dealing with the problems of attributing income to factors of production or to areas.

Q. So that if there were no costs, obviously there would be no income?

A. Well, we must be a little careful about universalizing anything about that. Property sometimes is inherited or acquired by other means than purchase. What I was talking about primarily was the prosaic situation, however, where you are purchasing services and materials and supplies and constructing buildings and buying equipment, and so on; but I wouldn't say that there aren't a few exceptions. Treasure trove might be income to the person who was the beneficiary under the law, but he might not [fol. 76] have any particular costs.

Q. But in business activities you, as I understand it, place your emphasis and form your predicates from the approach of costs, basically and primarily; am I correct, sir?

A. Yes, relative costs incurred is the thing I was trying to stress.

Q. Let me give you a hypothetical approach.

Suppose you had a corporation which was engaged either in servicing or selling, yet had all of its products in one place, it incurred all of its costs, essentially, in that place, but by fortuitous circumstances it made all of its sales in another place, and the total costs of accomplishing this sale were de minimis—let's say $10,000 to make all of the sales of the commodities, as against $10,000,000 for the production of the commodities which were sold.

I take it that in your view, then, none of the income would have been produced with the exception of that related to $10,000 in the area where the sales of the commodity occurred, and all of the income would have been produced in the area where the major or almost total costs were incurred?

A. I think that is substantially correct. I would like to try to illustrate your case.

Let's imagine a manufacturing company—this is a little weird—producing something or other within one state, and perhaps selling it all in another state, the whole thing.

[fol. 77] And perhaps their sales effort might conceivably be a few catalogs scattered around that state, or something of that sort.

Now,—

The Court: Let's suppose it wasn't anything.

The Witness: Let's suppose for the sake of extreme hypothesis it wasn't anything.

In my opinion the income of that manufacturing and vendor corporation is generated in the other state. That doesn't mean that it isn't realized by sales in the second state, but it is generated by the activities in the state, in the state in which the work is done, in my opinion.

By Mr. Wixon:

Q. You realize, sir, that we cannot in our concepts, based upon counsel's question to you on the Franchise Tax Act, tax anything but realized income. That is to say, we cannot tax a mythical dollar, we must tax an existing dollar, one which represents net income. You realize that, sir?

A. I believe that is my understanding, yes, that the type of tax we are talking about here is an income tax.

Q. It is called or denominated a franchise tax but is a tax, as counsel said to you, based upon income.

[fol. 78] A. Yes, I so understand the situation.

Q. Now, sir, let me ask you this. Suppose a corporation purchases articles which it sells or manufactures them or in any event obtains them and in so doing it incurs a cost because there is a cost of the merchandise purchased on the one hand or produced on the other. Do you agree, sir, that it is rather immaterial how the costs are incurred since it is the commodity which is, when sold, the item which produces the income?

A. I don't believe I quite followed that. Could I have that read?

Q. Yes, sir. I am a businessman and I buy commodities for sale. I manufacture nothing, but I purchase them from someone else and in so doing, of course, I incur costs for those particular articles. Now I differentiate that situation from the one we have been talking about, a manufacturing corporation which produces substantially all of the things

that it sells. Would you say that there is any major distinction to be made between the income type production of the business which purchases everything and sells it and the corporation which produces everything it sells or is it still based upon expense or costs in either case?

A. Well, let's think of some commission merchant or somebody who buys a lot of stuff and maintains an office and sells it quickly. Now his activity is that of acting as a trader, let's say, at the wholesale level perhaps and his income is produced as a result of that activity and when we come to a geographical assignment of it, I would say that it depends on where that activity is located and where [fol. 79] those costs are incurred by him as to how that assignment should be worked out.

Q. Using the example of the company which produces nothing but buys everything which it in turn sells, would you say that if the articles are bought, for example, in Minnesota that therefore the costs are incurred in Minnesota and that the income therefore is attributable or to be assigned to Minnesota?

A. Certainly not, if the activities of this party we are looking at is centered in and located in Chicago. In other words, the fact that he incurs a cost in Chicago for something that comes from Timbuktu would not mean that Timbuktu has any claim to his income. Maybe Timbuktu—

The Court: Mr. Wixon said the man went out—

Mr. Wixon: Buys things in Minnesota.

The Court: He is physically there.

Mr. Wixon: I go to Minnesota and purchase a million dollars worth of merchandise which I have sent to me, or I bring back with me, to a place in Michigan.

The Witness: I didn't quite understand the situation. The question of geographical assignment does not depend on just where the home office is, but it depends on where the man's activities are and—

[fol. 80] The Court: Do you think every State the man would go to buy that material would have a right to nick the corporation for an income tax?

The Witness: It is an interesting question. My concept is simply this, your Honor, that the income of a particular enterprise or taxpayer is generated by its efforts, a whole package of efforts, and I use costs as a measure, in general, that is available of those efforts.

By Mr. Wixon:

Q. It is true, is it not, Professor Paton—

A. Excuse me, but if he makes a trip out there, even if he is located somewhere, even if he makes habitual trips—

The Court: He didn't say "habitually." Say once a month.

The Witness: It is an interesting question whether a State should assert a claim or a right to tax income of someone whose activities, although scattered around a bit, are very incidental to that State. The fact, if his activities are centered primarily somewhere else, the fact that he buys goods in Minnesota would not warrant the conclusion that Minnesota is entitled to levy a tax on any of that income. But if he goes out there to negotiate and carries on activities—

The Court: Mr. Wixon didn't ask you about that.

By Mr. Wixon:

Q. You have assigned, Professor Paton, in your testimony, as I have understood it, to the place where the costs [fol. 81] incurred the income which is the ultimate result of the activities of the corporation.

A. That is my proposition.

Q. That is your proposition. So that if you follow this matter to its logical conclusion, does it not follow that the place where costs are incurred, wherever that may be, and for whatever reason, is the place where the income ultimately resulting from the activity will have to be assigned according to your approach?

A. I think that is correct.

Q. Now it is a fact, is it not, Professor Paton—from the accounting viewpoint certainly that it is considered wrong to count your chickens before they hatch. In other words, you must have a sale, a culminating activity before you take into account income for business purposes or for tax purposes or for practical purposes?

A. Well, the question in the first place there is a distinction, as I see it, between the earnings and production,

generation of income, and the final step realization. You take in the case of an integrated company that has a mine and also owns some ships, a transporter, owns a smelter and a rolling mill and so on, I just can't accept the proposition that some of those important operations have to be left out in the cold as far as income is concerned because it might happen that a good share of the final product is maybe sold abroad or sold in some area other [fol. 82] than where all this effort is made and all this cost incurred.

Now, with respect to the other phase of your question, what do we in accounting recommend, it is true that in most manufacturing and trading enterprises the so-called conservatism of the accountant leads him to recommend the accounting recognization of the income when the amount of the sale becomes certain, but I don't know of any accountant who would say that final step of making the consignment and trundling the sack of cement into the freight car would say that that was the act that produced the income. That has never been my understanding. I very, very explicitly have taught to the contrary all through the years and I have assumed that I was in line with that.

Now, there are special situations, counsel, where we do deviate from that. For instance, in long-term construction, it has been a recognized principle for many decades that income may be recognized as construction progresses (per se) because otherwise you may get very periodic distortions. It is one thing to be manufacturing umbrellas, let's say, and it is another thing to be building ships for some client that may take him months or even two or three years to complete.

There are other exceptions that are made. I think that we generally recognize in accounting that it is the entire activity that generates the income, but that as a matter of conservatism we don't recognize it prior to delivery of the product or consignment of the product to the [fol. 83] customer. I don't see any conflict at all between recognizing the realization of the income at that point and insisting that the entire process of production, including marketing, is the process that generates or is responsible for the income.

Q. Well then, I take it, Professor, following again your thoughts to what I would think would be a logical conclusion, that you would say that it would be possible perhaps to impose a tax upon potential income realization even though the products manufactured or purchased for sale had not in fact been sold since upon the obtaining of the products for sale there was in effect income determination.

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The Witness: Let's imagine an ore mine out in Minnesota and the company owns the mine and also owns some ships in which the ore is transported, and a smelter and rolling mill, and what not in Cleveland or Pittsburgh or somewhere. Now, in my judgment whatever income finally results from the integrated operations of that company must be attributed to the entire process.

The Court: Let's suppose one of the big ore ships coming down the Detroit River sinks. Certainly it has not earned any income. That segment of the business has not earned any income.

The Witness: I could not quite agree with that. I would say those miners had produced income up to that point. Another misfortune nullified it—

[fol. 84] The Court: You don't think income sank along with the boat, do you?

The Witness: I don't think that is at all difficult, sir. The value added—

The Court: There is no income until that boat reaches Cleveland and it is made into steel and steel was sold.

The Witness: I am afraid you and I do have a fundamental disagreement.

The Court: What happens if the boat sunk?

Let's take fifty thousand tons of ore. It is ore that was mined and put on that boat, and it gets right in front of Detroit and sinks. Has that segment of the business earned any income?

The Witness: Yes, sir, because the value of the ore that sunk and your ability to collect insurance on it would—

The Court: Let's assume there is no insurance.

The Witness: O. K., but each step in the productive process does, generally speaking, add a value.

The Court: You are talking in generalities?

The Witness: I am talking about this ore that is in this boat. That is a bigger loss to you. Suppose for instance, that ore were somehow lost or destroyed before we got it loaded on the ship.

[fol. 85] The Court: Yes, sir, any place.

The Witness: Our loss would not be as great as it is when it is destroyed down here in the Detroit River.

The Court: Doesn't make any difference. Is there any income?

The Witness: In my opinion, I don't see any reasonable escape from it. We cannot leave any of these activities out in the cold. Something may happen to nullify or cancel the beneficial or worth-while effect, as for instance, some foreign government seizes your property, but that does not mean that the loss is not different when you have semi-finished goods than it is when you lose raw material, because you are adding value all the time, sir, as you are carrying forward your production.

The Court: Let me go a step further. Let's suppose it was received in Cleveland and made in steel, and something happened and all of the steel was destroyed, before it was sold to any customer.

The Witness: Then you have lost a lot more than you would have lost if you simply lost the ore.

The Court: I agree with that, but it still has not earned any income, has it?

The Witness: The fellow that has carried it to that stage, could say he has produced income and then a casualty or storm or something else has caused an equal or com-

[fol. 86] pensating loss. They are two different things.

The Court: How can you lose something you have not earned?

The Witness: Of course, as I have said all along, I consider that earning or production process is distinct from final cashing in on it. Like I was trying to say about growing the apples, I think when you grow the apples you have done something.

The Court: You never heard of the severance theory?

The Witness: Yes, sir.

The Court: When you use the apple tree as an example I think you made a mistake. I think what we have to do here is shake the apple from the tree. And it is not shaken until it is sold.

The Witness: As I say, there are well-recognized situations, that are orthodox for Federal income tax purposes, and have been in effect for at least fifty or sixty years, where income is recognized on cost plus fixed fee contracts as and in construction as the work progresses.

The Court: Don't misunderstand, most of this discussion is academic because the statute requires that the income earned be outside where business is conducted and inside where business is so it is somewhat academic?

[fol. 87] The Witness: That is why I think we are not quite as far apart as we seem to be.

By Mr. Wixon:

Q. Professor Paton, you are the author of "An Accountant's Handbook," which is, I believe, one used throughout the country?

A. Well, that is not quite right, I was the editor in chief of two editions of the "Accountant's Handbook," the 1932, as I recall it, edition, and the 1943 one.

Q. I have your third edition, sir. It is dated 1945, the Ronald Press Company, New York, entitled "Accountant's Handbook," third edition, edited by W. A. Paton, Ph.D., CPA, Professor Accounting, University of Michigan.

I would like to show you this volume, sir, and ask you if this is the volume that you edited?

A. Yes, sir, I don't need to examine it, I am sure that it is.

Q. If you care to, sir, you are welcome to do so.

A. No.

Q. Do you believe the statements in the Accountant's Handbook which you are the editor of, reflect, generally speaking, accepted approaches in the matters to which reference is made in this handbook?

A. Well, it has been a long time since I have worked on it or examined it, but overall, it is my impression that it is a pretty good compendium. It represents, to some

extent, the—it brings together in some cases, conflicting [fol. 88] ideas, that is not everybody is agreed on every single aspect of all of these problems that arise in business, but I have always, I have never hung my head so far when anybody has mentioned the fact that I was editor of those two editions.

Q. I take it, sir, when you had material inserted in this volume, you were satisfied in your mind that it was correctly placed there?

You did not put things in there that were incorrect?

A. You must bear this in mind, I was dealing—I am not trying to evade the question at all here, let's get this thing straight—I was dealing with literally scores of temperamental advisors and contributors and I can't say that I wholeheartedly subscribed to every point—to all of the notions that were put forth. I had some influence in toning down some of the things that looked to me as if they were a little off base, and so on, but the overall effect, counselor, was pretty good and reflected a cross section of prevailing concepts and procedures at a moderately high level.

Q. I would like to read to you, sir, from Section 3 of the "Accountant's Handbook" that I have just shown you—at page 116:

"Relation of production to revenue. Although revenue is earned in a sense by the process of production as a whole rather than by some specific action, the accountant generally holds that it would be 'counting one's chickens before they were hatched' to accrue revenue prior to ef- [fol. 89] fective sale of product. To paraphrase a statement from Scott's Theory of Accounts, although it cannot be said that profit arises altogether out of the sale of the product and in no wise out of the process of manufacture, business practice and accounting authority agree that the expected margin on goods produced but not sold is not effective income. Even if the concern has a definite offer for the goods, the income involved is not realized if the transaction has not been completed. It is quite possible that while the goods are being held, the market will be affected adversely. If dividends were paid on such anticipated gains and these did not materialize, it is obvious

that capital investment would be depleted in the legal as well as in the operating sense. Where goods have been sold, on the other hand, the concern holds the accounts or notes of customers and no adverse change in prices can wipe out the profit involved, although failure to collect may. It is, therefore, permissible to include sales on credit in revenue with proper allowances for bad debts although no revenue be recognized on goods not sold."

Now this continues, sir, with a statement from Kester. Do you know Professor Kester?

A. Yes, sir, I do.

Q. Professor Kester, I think, is a recognized authority on the subject of accounting concepts and principles.

[fol. 90] Do you concur in that view, sir?

A. Well, he has written extensively and is well regarded through the field. He has been rather inactive for quite a good many years, but I believe Professor Kester is still alive. I have not seen him lately.

Q. And Professor Scott?

A. Professor Scott is deceased, but that is D. R. Scott, I believe, who used to teach at the University of Missouri, and I always regarded Scott as, on the whole, a pretty clear thinker and writer in the field of accounting analysis.

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Q. May I continue to read from this same place in the book. It is a continuation and it refers to Professor Kester:

"On the same point, Kester's Advanced Accounting writes substantially as follows: 'Should profit ever be taken on work in progress or goods made for stock, but not sold? Most concerns have at all times a more or less constant volume of work in various stages of completion. Conservative business policy generally demands that such goods be included in the inventory at cost, including an equitable share of burden accrued to date. This principle manifestly precludes the taking of any profit before the goods are sold.'"

I would like to continue with this, sir.

"In discussing this question, Gilman's Accounting Con-
[fol. 91] cepts of Profit, points out that, 'In most business situations, selling overshadows other business problems'

and that it would be 'fantastic' for a new company producing 'adding machines in competition with Burroughs, for example, to recognize income on the basis of production. The principal cases in which there is some ground for modifying the general rule are, one, production to order; two, construction. These cases are related in that construction operations are usually covered by specific contracts."

I have read you, sir, you may check this, if you care to, the entire statement under the heading "Relationship of Production to Revenue."

Do you concur in the statements found in this handbook, sir, of which you were the editor that I have just read to you in respect of the realization of taking into account of profits on goods which are not sold?

A. Well, there are a few points there which I would want to put the thing a little bit differently. The first few lines that you read, prior to the quotation from Scott, and the quotation from Kester, pretty closely expresses my present feeling, but I don't find myself at odds in any very sharp way with most of what was read. I think that these authors had in mind and indicate, from time to time throughout the quotations, the distinction between the generation or creation of income and to what efforts the income shall be attributed and the final step.

[fol. 92] The final step ordinarily, well, I suppose you would say the final step i collecting from the customer, as was pointed out in one of the quotations that you have read, we have generally speaking, not universally there either, but generally speaking, recognized the account receivable as the equivalent of cash and hence have treated the credit sale as an occasion for the recognition of revenue, recognition, not creation, the occasion of sale, as a convenient time to recognize revenue.

At that time the product generally speaking, not always, becomes physically separated from the vendor, and the vendor is in possession of either cash or an account receivable, which is a claim to cash, and in some instance, at any rate, might be discounted and with proper allowances made for bad debts, as was noted by one of the authors there, we can agree is not too non-conservative for an occasion for recognizing revenue.

I pointed out in this book of mine back in 1922, this distinction very clearly in a little diagram, the distinction between the creation of that added value as we go along in the various steps and cashing in on it, so to speak, and none of us, I am sure, can debate the proposition that if a salesman doesn't come in with his order, and particularly in the case of a highly specialized article that maybe isn't worth too much as scrap, if we don't complete the process, in other words, as in the case of the Court's examples of [fol. 93] product is lost through disaster.

The Court: I don't want to restrict counsel or the witness. Let me sugget that you just answer the question.

The Witness: I will try to, these things, your Honor, are a bit involved and I am faced with a long quotation that involves a good many points. But the gist of it, I would say is this, I think these people are agreeing that income is generated or produced by the entire process, but that as a matter of conservatism, in a good many areas, at any rate, we don't recognize it in our accounting reports and as I have already said in my direct testimony, until the revenue is supported by the value of products sold.

The Court: I think you have made your proposition clear. Let's not repeat it.

Mr. Wixon: May I now, sir, from the same volume, "Accountant's Handbook," at page 153, read to you this extract. It is headed "Realized and Unrealized Income."

"By 'realized income' is commonly meant income validated by sale and by 'unrealized income' accordingly estimated income not yet assured or realized through the fact of sale especially appreciation."

Do you agree with that, sir?

The Witness: I think that is substantially correct; yes, sir. It is a reflection of my views.

[fol. 94] By Mr. Wixon:

Q. Now, I take it from your last statement, Professor, that you would agree that ordinarily the word "income" means an amount realized as a consequence of some sort of transaction whereby a difference between the costs and the amount received for the article or services is obtained?

A. Well, I agreed with the paragraph or remark or two there about realized versus unrealized income. That is not quite the same thing as saying Yes to your present question.

Mr. Wixon: I see. I didn't understand that. I understood you to say that you agreed that realized income, as set forth in this volume, is commonly meant income validated by sale.

The Court: You didn't ask him. You asked him about income, and he said you should ask him about realized income.

Mr. Wixon: All right, sir. Realized income?

The Witness: The common view is precisely the view that is described or expressed in that sentence, that realized income, by that we commonly mean manufacturing and trading lines, income validated by sale.

You will notice, we didn't say recreated by sale, validated by sale. That is a very different thing and it seems to me—

[fol. 95] By Mr. Wixon:

Q. I would like to refer you, Professor Paton, to Accountant's Handbook, second edition, which bears your name as editor, publication of the Ronald Press.

* * * * * * *

Q. I am now reading from the second edition at page 1079, "Effect of Sale on Income."

> "In modern practice, the sale has become, in many fields, the well nigh universal basis for the recognition of revenue. As Kester says, Accounting Theory in Practice, volume 2, 'the basic principle is that normally the profit belongs to the period in which the sales effort results in an actual sale. The rule has a sound legal foundation in giving the vendee title to valuable goods, the vendor has acquired a claim which in itself is recognized property and which is on an altogether different basis from any claim he possessed prior to the actual sale."

Do you agree with that statement, sir? I have not read the entire statement under the heading "Effect of Sale on Income" simply because I tried to save time and I am picking those items in which I am interested. If you care to look at it, you are welcome to do so.

A. I should remind you, again in my answer, that this is an edited proposition to which a great many people contributed, but I think I find myself substantially in agreement with the statement there, that it is the rather typical [fol. 96] business practice to recognize the income in the period in which the sale is made and describing in my direct testimony briefly the content of the income statement, I proceeded in accordance with this view.

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By Mr. Wixon:

Q. As an accounting procedure, Professor Paton, with certain exceptions which I think you have referred to, isn't it considered to be bad practice to take into your books of account as recognized income, income which is projected to be earned in the future but which has not in fact been earned through sale or other transaction?

A. I think there would be almost universal opinion among accountants that income unearned should not be recognized but as I said before, we distinguish between unearned income. Unearned income would be the kind of income that the chap who has just mined the ore is projecting. Since they are daydreaming and he has that ore shipped down to Cleveland and it is made into a finished product, that certainly is unearned.

Q. Isn't that simply the conversion of one asset into another? If you take cash and buy something for that cash, aren't you converting cash into another item and then when you sell the item for cash, aren't you in turn making another conversion?

[fol. 97] A. I am not following you on that. The point I want to make in answer to your other question, which I don't think I have quite made, is I don't know of anyone that proposes that unearned income has any content. My proposition here today is that income is earned by the entire

process of production, and you can't leave any departments out in the cold.

• • • • • • •

By Mr. Wixon:

Q. Now, sir, when you get to production of items, whatever they may be, automobiles, busses, radios, anything along that line, aren't you just in fact converting one kind of an asset, money, or materials, into another kind of asset, which generally results in what we may call a finished product?

• • • • • • •

The Witness: I don't think that is a complete description of the process, your Honor.

The Court: But it is converting one asset into another.

The Witness: And thereby moving along the income producing road, even though he has not yet realized the income through sale—

The Court: I didn't ask you that. He asked you about converting one asset into another.

The Witness: I can't agree that is an adequate description of the process of production.

[fol. 98] By Mr. Wixon:

Q. Do you deny, sir, when you manufacture an automobile, you convert one asset into another asset?

A. Well, I am not going to adopt your language, sir; that may suit you but it doesn't suit me, as a description of the process of production.

Q. I didn't ask you that, sir. I asked you whether simply—

The Court: No [sic] said No.

The Witness; I don't agree with any such statement.

By Mr. Wixon:

Q. Do you think that produces revenue, sir, or income?

A. I think revenue is generated by the entire process, as I have said. I didn't know anybody would seriously question that.

Q. Does it produce income?

A. The entire process is what produces income; yes, sir.

Q. What is the reason you don't take into account on your books this income which has been produced when the one asset has been converted into another?

A. Several of the reasons were indicated in the quotation you read. The income has not yet been validated or realized through the act of sale. And many people feel, and I think justly, that that act of sale is a very important occasion and a convenient occasion for the recognition of income, but it doesn't follow or deny that some of the departments that are working on this contributed to the end [fol. 99] result.

Q. You were asked several questions about the type of formula you thought would be most appropriate, and I suppose it was related to the District of Columbia, since the statute was referred to by counsel. You have averred to a two-factor formula, as I recall?

A. Yes, I believe, in one of the questions the two-factor formula was raised.

Q. And, as I recall it further, those factors were essentially the factors of costs, in one form or another—payroll, I believe?

A. Payroll is certainly a cost factor, and property is an expression at least of capital and to some extent relates to the costs associated with capital. I don't think it is ideal, but as a rough guide it has some merit.

Q. You have rejected, as I recall your testimony, if not completely almost completely, the inclusion of the element of sales on the ground that the making of the sale and the total effect of this process was in a sense rather meaningless?

A. Oh, I wouldn't say that under any circumstances. I am very marketing minded. The making of the sale is very important, sir.

The Court: But not important in determining where income is realized?

The Witness: Only to the extent that the selling effort is exerted.

[fol. 100] The Court: But the sale itself?

The Witness: Just the sale, per se, I can't quite see that, without some selling effort being exerted there, can be thought of as a basis for the assignment, the attributing of the earnings to the various factors in production. Mind you, I am not leaving out the salesman.

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The Court: Yes.

Let's suppose now that General Motors sends a car or an automobile into the District of Columbia with a bill of lading and a draft attached; in other words, the dealer here is not to get the car until he pays the draft. Do you understand that?

The Witness: Yes, sir.

The Court: That is sometimes; I don't know if it is now, but it used to be when I represented automobile dealers, a very common way to deal. Now, when that car gets into the District of Columbia, it is owned by the General Motors. Do you agree with me on that? In other words, if the dealer refuses to pay the draft, then they turn around and send it back.

The Witness: It is my understanding it doesn't become the dealer's property until the draft is accepted.

The Court: Let's suppose that this automobile is sent here, and when it gets to the District line the police protect [fol. 101] it, stop people from stealing it and injuring it, and all facilities of the District of Columbia relating to automobiles are afforded the automobile, and even if the dealer may even be sued by the General Motors if he doesn't live up to his agreement in taking the car, anyhow, it doesn't belong to him until the draft is paid. Now, when that draft is paid, you will agree with me, that a sale takes place, doesn't it?

The Witness: I think, if I understand the transaction, yes, that is shipped with a draft attached, and it presumably would be the property of the company until the draft is paid.

The Court: Do you mean to tell me you do not believe that in a transaction or in any number of transactions of that kind, that it isn't proper to allocate to the District of

Columbia, to apportion to the District of Columbia, some part of the net income of the transaction of that car?

The Witness: I wouldn't say it was improper, especially—

The Court: Where is there any costs?

The Witness: If sales effort is exerted—

The Court: Where is any sales man or anyone else?

The Witness: I assume that there may be a— .

The Court: Not an employee in the District of Columbia, assuming it comes in here on a common carrier, and with a bill of lading and with the draft attached, and your theory now, inasmuch as there is no person in the District of Co-
[fol. 102] lumbia connected with that sale paid by General Motors, the District of Columbia shouldn't get any part of that income from that transaction?

The Witness: I don't think I am going quite that far.

The Court: I don't think you would. That is why I asked the question.

The Witness: Because this is property of General Motors under assumption, and it is moving in to the District, and you could say that General Motors in a small way is operating here in the District.

The Court: How?

The Witness: Well, it is moving one of its assets in here.

The Court: That is a purely ambulatory asset. You don't mean property in a form of that property?

The Witness: I would say if no cost whatever has been incurred by General Motors with respect to a sale or class of sales, at no cost whatever in the District of Columbia, that some other method than the income, then a tax, on General Motors income would be the only proper way to approach—

The Court: How much, what do you think would be fair to allocate, if anything, or apportion, if anything, to the District of Columbia? Let's multiply that by thousands of transactions.

The Witness: Well, in general, you do have selling effort involved in the marketing of goods.

[fol. 103] The Court: No selling.

The Witness: If we are going to assume—

The Court: I am giving you the acid test.

The Witness: All right, my response to the acid test is this, that if all of the activities of a particular enterprise—all, mind you,—are centered somewhere else than the District of Columbia, and all of the costs are incurred, all mind you, somewhere else that no part of the income is generated in the District of Columbia.

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[fol. 104]

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Wednesday, June 7, 1961

The above-entitled matter came on for hearing at 10:00 o'clock a.m.

Before: The Honorable Jo V. Morgan

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Proceedings

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WELDON POWELL was called as a witness for the Petitioner and, having been duly sworn, was examined and testified as follows:

The Court: Give your name and address, please, sir, and take a seat.

The Witness: Weldon Powell, 2 East 70th Street, New York City.

Direct examination.

By Mr. McGratty:

* * * * * * *

Q. What is your occupation?

A. I am a certified public accountant of New York and 23 other states; I am and for the past 27 years have been, a partner in the firm of Haskins and Sells.

[fol. 105] Q. Will you state the nature of the business of the firm of Haskins and Sells?

A. Well, this is an international firm of certified public accountants. We have offices in 42 cities in the United

States and representation through our own offices, associated firms, or correspondents in practically all areas of the free world. In Canada, for instance, we have offices in ten cities.

Q. What type of clients does the firm of Haskins and Sells serve?

A. We serve all types of clients, both large and small; we have clients engaged in manufacturing, mining, oil, agriculture, finance, insurance, brokerage, amusements, real estate; we also have a number of non-profit organization clients—hospitals, foundations, educational institutions, governmental bodies. General Motors Corporation is one of my firm's clients and has been since 1916.

Q. What are the type of services, in general, which the firm of Haskins and Sells renders to its clients?

A. We render all kinds of services that professional accountants customarily render. Auditing, of course; in addition we deal with accounting aspects of taxation, management consultation work, and the like. During recent years this last has become quite important because nowadays a great many businessmen rely upon their certified public accountants to advise with them concerning many aspects of their businesses.

[fol. 106] Q. Will you please state your educational background?

A. I attended the public schools in Logansport, Indiana; Indiana University and the University of Illinois. I took the accountancy curriculum and received a Bachelor of Science degree in 1922; I received the Master of Science degree in 1923. I taught accounting also at Illinois for two years.

Q. Have you had any special training and experience in the field of economics?

A. Well, I studied economics as an undergraduate student at both Indiana and Illinois and took practically all of my elective courses in economics, although I took my major for my Master's degree in accountancy, I minored in economics and stayed on for one year studying principally economics because at that time I had intended to become a Professor of Economics and to take my Doctorate in that work.

Circumstances which are not pertinent here subsequently changed my mind, but I did do quite a little studying of economics. Of course, any professional accountant has to deal with economic data because accounting is largely the classification and analysis and interpretation of economic facts.

I am a member and have been for forty years of the American Economic Association.

Q. How long have you been associated with the firm of Haskins and Sells?

[fol: 107] I joined the firm of Haskins and Sells in 1924 and have been variously in the Newark, Los Angeles, Detroit and New York offices. I am presently located in the firm's executive office in New York and I have overall responsibility for the firm's technical accounting and auditing procedures.

Q. Are you a member of any professional accounting organizations?

A. Yes, I am a member of the American Institute of Certified Public Accountants, the American Accounting Association, the National Association of Accountants, the New York Society of Certified Public Accountants, and the State Societies of Certified Public Accountants in a number of other states; I am a member of two honorary societies, Beta Gamma Sigma and Beta Alpha Psi.

Q. Have you held any offices in any of these organizations?

A. Yes, I have held various offices and committee posts in these organizations. I am a past vice president of the American Accounting Association, which is an organization composed largely of teachers of accounting. I have been a member of the committee on Accounting Procedure of the American Institute of Certified Public Accountants prior to its discontinuance a few years ago; and at present I am Chairman of the body which succeeded it, the Accounting Principles Board.

[fol. 108] Mr. Wixon: If your Honor please, I am quite willing to concede the qualifications of Mr. Powell as a certified public accountant.

The Court: I don't understand it is limited to that, Mr. Wixon, but you do not have to explore it any more as far

as accountancy is concerned. If you want to qualify him in any other respect—I take it from one question you are not limiting it to accountancy.

Mr. McGratty: No, your Honor; there are one or two other questions I would like to ask in this connection and I will pass on.

By Mr. McGratty:

Q. You mentioned, I think, the American Institute of Certified Public Accountants; would you state briefly what the nature of that organization is?

A. It is a national organization of certified public accountants, it has some 40,000 members, and, of course, is the counterpart in the accountancy profession of the American Bar Association in the Legal profession.

Q. I think you stated that at the present time your chairman of the Accounting Principles Board of the Institute.

Will you state what the Accounting Principles Board is of which you are the Chairman?

A. It is composed of 21 members of the Institute, it is a new organization developed within the last two years fol- [fol. 109] lowing a year's study of the Institute's efforts in the field of accounting principles and it is intended to undertake research into matters of accounting principles and to make pronouncements on matters of accounting principles for the guidance of the members of the Institute and of others.

It is the sole body in the institute that has authority to speak on matters of acounting principles and is going to be quite an organization. When we are fully staffed we will be spending approximately a quarter of a million dollars a year on this work.

Q. Mr. Powell, to what extent is accounting concerned with the determination of net income from business transactions?

The Court: You mean generally?

Mr. McGratty: Yes, your Honor.

The Witness: One of the most important aspects of accounting is the determination of income from business transactions; in fact, during recent years there has been a

notable tendency on the part of many persons, especially businessmen, security analysts, and investigators to attach very great significance to income. They seem to regard as of more significance to them the statement which shows the results of operations of a business enterprise for a period of time; they regard this as more significant than they do the statement which shows the resources and liabilities of the business at a given point in time.

[fol. 110] When I speak of statements showing the results of operations, of course, I mean the statement of income which shows the revenues, costs and expenses and the net income for the period.

Some of the most intricate and most difficult problems of accounting arise in the determination of income because this is much more than a marshalling of figures on sheets of paper; it requires great skill and the exercise of considerable judgment to deal with some of these matters.

By Mr. McGratty:

Q. Would you state what in general is the nature of the problems which arise and which you encounter in connection with the determination of income?

A. Well, one group of problems relates to revenues; the definition of revenues, the classification, assignment to periods of time, and the like.

Another group of problems concerns costs.

What are the elements of cost? How does one allocate cost to products? To geographical areas? To periods of time?

The third relates to the matching of costs with revenues, seeing that costs and the related revenues are put into the same slots and the resulting net income is properly determined.

Q. Would you describe a little more fully what you mean [fol. 111] by this process of matching costs and revenues?

A. Yes.

The accountant assumes that any business enterprise incurs costs in order to produce revenues. A new business, for example, has to raise capital, it has to find office and factory space, it has to hire people. As it goes on it has to

engage in purchasing and selling and warehousing and building and accounting and collecting and shipping and all the other activities that a modern business enterprise has to engage in in order to keep going.

Now, all of these activities, of course, have costs attaching to them and it is the accountant's function to determine the costs, allocate them, and to match them against the revenues which arise out of the products these activities create.

That, generally, is what is known as the process of matching costs with revenues. There is one set of problems that arises in getting all of these things into the same periods of time, getting the costs into the same quarter, the same year as the related revenues. If the problem concerns itself with departments of the business or with different plants or geographical areas, states, counties or something of the kind, then it is necessary to get the costs and the related revenues into the same slots, as I said a minute ago.

Q. In this process of matching costs with revenues do you [fol. 112] consider that any one cost item is more important than any other cost item?

A. No. The accountant assumes that all kinds of business activities contribute to the production of revenue and they do not rank each other in doing so. He considers that net income does not arise until all costs have been provided for and that no one of them should be recovered in any order of priority as compared with the others.

In other words, revenues and net income result from a combination of activities rather than from any one given activity.

Q. How do you go about the process of matching costs to revenues and attribute net income where different phases of the total business activities of the business are carried on in different localities?

* * * * * * *

The Witness: Well, as I said a minute ago, the accountant assumes that all kinds of activities contribute to the production of revenue. On this basis net income, and as I said, all of these activities have costs related to them, so that he allocates generally revenue on the basis of costs incurred taking it area by area or department by depart-

ment as the case may be, so as to get costs applicable to particular plants, areas, jobs, or what have you, matched with the revenues that arise in or from those particular areas, jobs, plants, or what have you.

. . . . . .

[fol. 113] The Court: Why don't you ask him what his definition or concept of revenue is, what it means.

Isn't that very simple?

Mr. McGratty: I accept your Honor's suggestion with gratitude and will you state what your interpretation of the term "revenue" is?

The Witness: I think revenue is defined in one of the bulletins of the old Committee on Accounting Procedures of the Institute.

The Court: He asked you what your idea is.

The Witness: With which I agree, because I helped write it; as "the gross proceeds derived from the sale or service, the making of a sale of product or the rendering of a service to clients or tenants or others with whom the business has transactions."

Usually it is considered to be after deduction of any returns, allowances, or discounts customarily granted in the kind of business with which one is concerned.

In other words, it is the gross proceeds from the sale of products or the rendering of services in which the business is engaged.

That is the customary meaning of the term in accounting circles and I heartily agree with it.

As I said, I helped to write it.

[fol. 114] The Court: I think your question now may be asked, when in accountant's practice is revenue recorded?

I understand that is your question?

Mr. McGratty: Yes, your Honor.

The Witness: Revenue in accounting usually is considered to be earned as the productive processes of a business grind on. It is related generally to costs as costs are incurred for various services and what not, revenue is considered to arise, to be attributed to these because, after all, a business man does these things, incurs the costs only to produce revenue.

. . . . . .

The Witness: • • •

Usually for accounting purposes revenues are recorded, the recording of them is delayed until a sale takes place, an arm's length transaction or some other event arises in which the amount of the revenue is finally determined by the receipt of cash, the arising of a claim against a customer or a client or a tenant or some other similar event occurs.

This practice exists for pragmatic considerations largely, and because of the businessman's tendency to be conservative. A man buys something or makes it because he expects to sell it and derive income from it, but until he actually does sell it he does not know whether he is going to, so [fol. 115] that although he may be considering that he is adding value to a product and process all the time as he works on it, he delays taking up the revenue in his accounts simply as a practical matter until he actually sells it and knows that he has the revenue.

By Mr. McGratty:

Q. Are there any instances when revenues are recognized for accounting purposes as they are earned rather than when they are realized?

A. Oh, yes, I can think of several such instances. One is in the case of a contract where the price is firm and it is possible to estimate the cost with reasonable accuracy. An example of this would be many of the war material contracts during the last year, especially the cost-plus, fixed-fee contracts.

Another example would be a long-term construction type contract, as, for example, the building of a ship. A ship might take three years to build and it might cost $25 million.

If the businessman waited until he sold the ship he would have no income, nothing but costs for a couple of years and then a tremendous income in the third year, so he—

The Court: But he does get payment from the—

The Witness: He gets payment which he applies on the cost, that is right, but usually he takes up his income on [fol. 116] the basis of the costs incurred. If at the end of the first year, suppose the ship is estimated to cost $25 mil-

lion dollars and he expects to make ten per cent on it, so that it would be sold for $27.5 million at the end of the first year he may have incurred ten million dollars of costs. That is forty per cent of the total, so he would say he would take up forty per cent of his estimated profit on the sale or one million dollars.

The Court: Paying income tax on it?

The Witness: This method of accounting is acceptable for income tax purposes and many businessmen use it because it spreads their tax out over the period of the construction rather than ballooning it in the last year.

The Court: But they must get some payment before they can report any income?

The Witness: Usually the contractor agrees with his customer to get progress payments which generally are based on estimated progress. They usually are—

The Court: Something like an installment sale?

The Witness: That is right, they usually are designed to provide him with working capital with which to pay his costs over the period of the contract.

There are also some cases in the extractive industries, agriculture, where revenue is recorded as soon as a salable product emerges such as—

[fol. 117] The Court: Wheat, for instance.

The Witness: Wheat, for instance, whether or not it is sold.

The Court: Of course, it is property, it is like cash.

The Witness: Of course. These cases are acepted in practice as being instances in which revenue is recorded as costs accrue rather than when the sale is made eventually and in the case of the long-term construction type contracts, of course, this is an acceptable method recognized by the Institute and provided for specifically in one of the Institute's bulletins.

By Mr. McGratty:

Q. What about the—you mentioned agriculture. What about the extractive industries?

A. Extractive industries, mining, gold mining also.

. . . . . .

Q. Mr. Powell, were you present in Court yesterday, did you hear the long hypothetical question which I addressed to Professor Paton, and do you have in mind the facts which I asked him to assume?

A. Yes, sir.

Q. Have you read and do you have in mind paragraphs 9 and 10 of the supplemental stipulation which is Petitioner's Exhibit 6 herein?

A. Yes, sir.

* * * * * * * *

[fol. 118] (The hypothetical question was read to the witness.)

Q. On the basis of the facts and figures contained in that hypothetical question and the facts and figures set forth in paragraphs 9 and 10 of Petitioner's Exhibit 6, do you have an opinion as to whether the sum of $5,156,525 represented the approximate portion of the total net income of General Motors fairly attributable to the business carried on by General Motors in the District of Columbia in the year 1957 and whether the sum of $2,707,677 represented the approximate portion of the total net income of General Motors fairly attributable to the business carried on by General Motors in the District of Columbia in 1958?

The Court: Now, Mr. Wixon, you object to that?

Mr. Wixon: Very strenuously, yes, sir.

The Court: You object to it on two grounds, one that the witness is not qualified to testify as an expert on the subject, and second, that the question does not contain all the facts that are necessary to properly present the question?

Mr. Wixon: And thirdly, sir, on the ground that this witness, the qualified certified public accountant is being asked his opinion on a subject of law.

The Court: All right.

[fol. 119] I am going to overrule your objection as to the subject matter of the hypothetical question because I think it fairly states what the situation is. As to the qualifications, I am not quite certain in my mind whether or not the witness is qualified from economical as well as accounting standpoint and I think it's involved, although I am inclined to the view and I want him to explain a little bit more, and

I can't escape it, that in a higher echelon of accounting economics plays a very important part and I think it's almost as important as the accounting itself.

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The Court: I understand your objection.

Mr. Powell, would you explain a little more fully what part economics plays in the work you do in accounting, in the field of accounting in which you are practicing?

The Witness: Economics plays a very important part, Your Honor. As I indicated briefly a short time ago the accountant deals constantly with economic data, he classifies it, analyzes it, interprets it, reports it. For example,—

The Court: I'm talking about you now.

The Witness: I'm talking about myself also, sir.

The Court: All right.

The Witness: For example, in this work that I am doing [fol. 120] in the American Institute of Accountants Accounting Principles Board, one of the problems that we are wrestling with at the moment is accounting for inflation which certainly is an economic phenomenon, not how does one do it mechanically, but is it something that really should be done and how should it be presented to people. Is it meaningful to report to stockholders, to management on the basis of current dollars or historical dollars, or what? It's a very involved thing and involves all kinds of economic considerations. We have economists, professional economists working with us closely on this matter.

The Court: Well, you testified that in recent years accountants, and I don't know whether that included you or not, are called upon to consult with management.

The Witness: That is right, we do a lot of that kind of thing.

The Court: To what extent have you done it and what characterizes your consultations?

The Witness: I have done it to a very great extent. My clients frequently consult with me before they enter into business transactions as to what my view as to the possible implications of certain aspects of these is, how it will affect their financial situation, their reporting—not only the entries on the books, that is the smallest part of it, because

once one determines what the facts are and what the situa-
[fol. 121] tion is, the manner in which they are recorded in the books is a very simple and very menial matter.

The Court: To what extent do you do this work? How extensive is it?

The Witness: A modern accountant, including myself, does this a very substantial part of his time. I might say that in my own firm the extent to which we use clerks has very greatly decreased, even since I started out in my career 40 years ago. We have very few men in our firm now who do purely mechanical and menial work; practically all of our work is head work and the partners of the firm of which we have approximately 200, all of us spend our time doing this kind of work pretty largely.

The Court: I'm going to overrule your objection, Mr. Wixon, with respect to the qualification of the witness.

Now, with respect to law, I don't exactly know what your objection is. If you could elaborate maybe I might agree with you, I don't know.

Mr. Wixon: I would be happy to, sir, as best I can.

This gentleman is being asked to give his opinion as to whether a certain amount of income of General Motors Corporation which was apportioned to the District and against which a tax was assessed, was fairly attributable to the trade or business of General Motors in the District of
[fol. 122] Columbia.

The Court: Not whether the tax was fairly attributable.

Mr. Wixon: Well, the income.

The Court: The net income on which the tax was based?

Mr. Wixon: That's simply a pro forma operation.

The Court: All right.

Mr. Wixon: Now, the facts recited in this hypothetical question as best I can recall them in substance was that General Motors produces products for sale, it does not produce them in the District of Columbia, it produces them outside, but it sells them in the District of Columbia. On the basis of that very summarized statement, at least so far as I have made it, this gentleman is asked the question, let's say, whether the income which has been recited to him and which was determined by the District was fairly attributable to the business done in the District.

Now, actually I would like to say this, your Honor, in my view his only answer could be yes because the only business in the District of Columbia is recited to be that of selling products manufactured by General Motors Corporation and, thus, since the only business recited to him is the selling business and the servicing, of course, the necessary things—

The Court: They recited that it was manufactured some place else.

[fol. 123] Mr. Wixon: The statutory definition is trade or business in the District of Columbia. What I'm trying to say, sir, is simply this, that if the only business of General Motors in the District of Columbia consists in selling, then the results of that activity make the income resulting from it fairly attributable to the business. It's a question of law, and this gentleman is being asked to express himself as to whether in his view, as a matter of law really, the amount of income is attributable or fairly attributable to business in the District of Columbia.

Now, that is the ultimate determination, that is the thing which Your Honor and perhaps the Court of Appeals, perhaps the Supreme Court, may have to decide, but it's not for this gentleman to express himself upon whether he believes as a matter of law, which in essence he is asked to state about, as a matter of law the amount of the income so determined by the assessor is fairly attributable to the activities of General Motors Corporation. It's not in the District, Your Honor, the hypothetical question as I recall it leaves that out, although it was mentioned, that is to say, the statutory definition was mentioned.

Now, may I suggest to Your Honor one more thing. This statute includes a lot of other provisions such as what should be considered income for purposes of tax? None of that is in the hypothetical question, a matter of law.

The Court: Mr. Wixon, I have before me continually, like a ghost at the banquet, this provision of the law with [fol. 124] which you are familiar, that if the business is carried on within and without the District the income must be apportioned within and without the District, and I can't get away from it, and I'm going to overrule your objection

as to the law, because I don't think the witness testified about law at all, so I will let him answer the question.

* * * * * * *

By Mr. McGratty:

Q. You do have an opinion?

A. Yes.

Q. Will you state what that opinion is?

A. I do not think that the amount of $5,156,525 in 1957 and $2,707,677 in 1958 represent the portion of the total income of General Motors—

The Court: What kind of income, net?

The Witness: The total net income of General Motors Corporation fairly attributable to its activities within the District of Columbia, which I understand was your question.

By Mr. McGratty:

Q. Will you state the reasons for that opinion?

* * * * * * *

The Witness: As I attempted to indicate earlier it is my view that revenue, and therefore, net income, arise from the application of resources and effort, that is capital [fol. 125] and labor if you like to use those terms, the amounts I mentioned were determined, as I understand it, solely upon the basis of sales and did not give any attention or weight to these factors which I consider to be important.

For example, in 1957, the amount allocated solely or apportioned solely on the basis of sales is about 18 times the amount that would result if it were based upon property, about 8 times the amount it would be if it were based upon payroll, the two factors that seem to me to be fundamental.

In 1958 it's about 20 times property and 8 times payroll, and in both years it's about six times the total, and I regard this as a disproportionate result.

By Mr. McGratty:

Q. On the basis of the same facts and figures which I have asked you to assume to be correct, what is your opinion with respect to the use of a payroll factor alone for the purpose of determining the portion of the total net income of General Motors fairly attributable to the business carried on by General Motors in the District of Columbia in 1957 and 1958?

* * * * * * *

The Witness: In my opinion this would not produce a precise result because while it recognizes one of the [fol. 126] elements underlying revenue, namely, payrolls, or the application of effort, labor, it recognizes only one. It does not take into account the other fundamental factor, namely, the use of property or capital.

By Mr. McGratty:

Q. On the basis of the same facts and figures, what is your opinion with respect to the use of a property factor alone for the purpose of determining the portion of the total net income of General Motors fairly attributable to the business carried on by General Motors in the District in 1957 and 1958?

* * * * * * *

The Witness: In my opinion it would not produce a precise result either for while it recognizes the other factor, namely property, it ignores the fundamental ingredient of labor and payrolls.

* * * * * * *

Q. On the basis of the same facts and figures, what is your opinion with respect to the use of a property factor plus a payroll factor for the same purpose?

* * * * * * *

The Witness: In my view this would produce a reasonable approximation in as much as it recognizs what seemed to me to be the two fundamental factors which give rise to revenue, namely, the use of resources or capital and the application of effort or labor.

By Mr. McGratty:

[fol. 127] Q. On the basis of the same facts and figures, what is your opinion with respect to the use of a property factor plus a payroll factor, plus a destination sales factor for the same purpose?

* * * * * * * *

The Witness: Well, the introduction of sales in my view from the standpoint of accounting theory brings in an extraneous element and to a certain extent duplicates the other factors and I would prefer to have the two factor formula; however, I do not believe that the distortion would be very serious.

* * * * * * * *

Q. What is your opinion with respect to the use of a gross property value factor that is original cost without regard to depreciation which has already occurred as compared with the use of a net book value after depreciation property factor?

* * * * * * * *

The Witness: I prefer the use of the gross book value property factor before deducting depreciation. It represents the amount actually invested in the facilities which are being used and gets around possible difficult questions of depreciation methods and allocation and all of that kind of thing, and it is easy and simple to apply.

* * * * * * * *

The Court: I don't think you have the book value here in your stipulations, do you?

[fol. 128] The Witness: I will say original cost.

* * * * * * * *

Cross examination.

By Mr. Wixon:

Q. I understand General Motors Corporation is a client of your firm; is that right, Mr. Powell?

A. That is correct.

Q. And has been for how many years, sir?

A. 45.

Q. 45 years?

A. Yes.

Q. Have you had any personal association with General Motors?

A. Yes, sir, I was in charge of the work in Detroit for four years and I was in charge of the general supervision of the work throughout the world for four years.

Q. I take it you are paid by General Motors Corporation for the work you do?

A. You mean in this case or—

Q. In any work that you do for them.

A. We are paid for our services based upon the time that we spend, yes, sir.

Q. Is General Motors considered a good client of Haskins and Sells?

[fol. 129] A. Yes, sir.

Q. A good client to retain?

A. Yes, sir.

Q. I gather from the testimony you have just given that you don't think that the incident or element of selling something has much to do with income?

A. I did not intend to convey that impression, sir. Of course, income comes into being the minute a sale is consummated. It arises, however, accrues, as the manufacturing or productive process goes on.

Q. Are you familiar with the Federal taxing acts?

A. I have done some tax work, although I do not pose as a tax expert.

Q. As a convenient matter under Federal tax law is a tax assessed against someone who has not sold something and gotten from it an income?

A. Generally not, although there are exceptions as I indicated previously in discussing the matter of the shipbuilder, the reporting of income on the basis of progress of work even before the product is delivered is an acceptable tax practice.

Q. It's acceptable but it's not required, isn't that true, sir?

A. That's right, the contractor—

[fol. 130] The Court: Just a moment. In that case the man received installment payments, didn't he?

The Witness: The installment payments, however, do not necessarily—are geared largely to the contractor's estimate of costs and are intended to provide him with working capital during that period. They are not intended as a measure of revenue while the work goes on and the tax is not based upon the progress payments he has received, it is based upon the percentage of completion as measured by the costs.

The Court: Because it's on an accrual basis?

By Mr. Wixon:

Q. It's an allowable or permissive method of reporting income for Federal tax purposes, is it not, sir?

A. As I understand it it is, sir.

Q. And it is not a required method?

A. That is my understanding.

Q. Now, as a matter of fact, hasn't the accounting profession to a large degree geared itself to taxing accounts?

A. No, I would say that is not the case.

Q. As a matter of fact, Mr. Powell, isn't it true that from the standpoint of reporting income on installment type sales and on contract type operations such as you have just discussed, accounting tends to follow the Federal taxing approach to the same subject matter so that in [fol. 131] the keeping of the records of the corporation for tax purposes you would not have to have two sets of books?

A. I would not think that that was the case. There are many instances in which concerns report income on an installment basis for tax purposes and on an accrual basis for financial reporting purposes. In fact, one of the projects of the Accounting Principles Board at the moment is a study of the effect of differences in accounting between tax requirements and what is considered to be generally accepted accounting principles.

Q. Well, now, I don't want to be unduly repetitious here, but do I understand that the taxing statutes have not had significant influences, in your opinion, upon accounting procedures?

A. No, I did not mean to say that.

Q. Well, have they had a significant effect?

A. They are one of the things that is taken into account in determining accounting principles and there are a number of instances in which the tax laws have had a very significant impact on accounting principles, but I do not wish to be understood to say that accounting is influenced in all instances or even very substantially by the tax laws, because there are many differences between accounting and taxing.

Q. Now, you have spoken, sir, about revenues. I think you used the work revenues, I don't know whether you used these in contradistinction to income, nevertheless, you have used the word revenues, in respect of contract type [fol. 132] sales where progression was reflected on the books so far as revenue was concerned?

A. That is right.

Q. And you have also mentioned installment sales—

A. That is right.

Q. —as being one of the—as being in an area where revenue is reported on the books as the contract installments are received?

A. An installment sale and the contract construction accounting are two different things. In the case of the construction contract the sale takes place, the delivery takes place after a longer series of steps. In the case of the installment sale, the sale takes place now and the collection occurs in a number of steps afterwards.

Q. But in each instance, each of those two instances, there has been in effect a sale, has there not, of the product, even though delivery may not occur simultaneously with the making of the contract as in the instance of the vessel which is to be completed in 16 months on a contract for its construction?

A. The question as to whether a sale has taken place I would think would be largely a legal question, but from an accounting standpoint I would not think that the ship was sold until it was delivered.

Q. But nevertheless there is an enforceable contract present there in the case that you yourself have talked about, the vessel will be completed and delivered at some time in the future?

[fol. 133] A. That is right.

Q. And in the case of the installment sale as such there has been in all probability, certainly, an enforceable contract.

A. An enforceable contract at the time delivery takes place, collection to follow over a period of time.

Q. Now, an accountant does not take into account income in the absence of one of those two activities, does he, as a general rule?

A. As a general rule that is so, although, as I pointed out in the case of the shipbuilding contract or it is quite common practice to take up income as the work progresses in advance of the sale.

Q. I said, sir, giving due regard to the contract that you referred to of the building of a ship and giving due regard to the installment sale, isn't it a fact that in any other situation, there may be some subsidiary ones that we haven't talked about, but in any other situation as a general proposition in accounting is it not considered to be bad practice to take into your books income until a sale of the product has occurred, or the rendition of services has occurred which gives rise to the receipt of the income?

A. In ordinary commercial and industrial practice that is the case; yes, sir.

The Court: Would it be the proper way insofar as General Motors operations are concerned?

[fol. 134] The Witness: In the case of General Motors Corporation revenue usually arises, I think it all times does, when a sale occurs. There was a time during the war when the corporation had a number of war material contracts and perhaps it still does in some of the divisions when income is taken up as work progresses.

The Court: We are not concerned with that, we are talking about the segment of business here.

The Witness: In the case of automobiles and locomotives and things of that kind, that is so, yes, sir.

By Mr. Wixon:

Q. And instead of using the word "revenue" may we use the word "income"?

A. Well, revenue and income are different things, sir. Revenue means the gross proceeds from the sale; income is what is left after deducting the costs.

Q. And when you take into account your income, net or gross—

A. Income is a net concept, sir.

Q. I'm using it now in a different sense. When you take into account your income, gross or net, I realize your approach to the thing, you do not take it into account into your books of record until the sale has occurred; is that correct, sir?

A. That is ordinary practice in commercial and industrial enterprises.

[fol. 135] Q. And that would be true in the case of General Motors Corporation?

A. Except for some of these things like the war material contracts, yes.

Q. Are you familiar with the definition of income under the Income and Franchise Tax Act of 1947?

A. I have read it, I do not recall the details of it at the moment.

Q. Would you please—this is a reprint by the District of the District of Columbia Income and Franchise Tax Act of 1947 with amendments, and I use and express to you the words "gross income" and "net income."

Would you please, sir, look at Title 3, Section 2, on page 7 of this and see if that refreshes your recollection of that?

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Q. Generally speaking, that definition is comparable to the federal definition of gross income, is it not, sir, in your recollection?

A. I believe so.

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Q. Now, if General Motors Corporation sells an item which cost it some sum of money but for which it receives "X" dollars, that sum of "X" dollars is recorded in the books of records as "X" dollars, is it not, sir?

[fol. 136] A. That is right.

Q. And thereafter there are taken from the sum of "X" dollars those expenses which relate to the receipt of "X"

dollars so that you get ultimately net income, is that true, sir?

A. I would not say it is thereafter, it is at the same time, simultaneously.

Q. The time of the happening is immaterial, but nevertheless you record the total amount received?

A. That is right.

Q. As income. And you do not record that income, that gross income until the sale has been effectuated?

A. As a matter of ordinary business practice that is the case; yes, sir.

Q. And isn't that ordinary business practice conceded in accounting to be the correct business practice?

A. I would not say it is a case of being correct or incorrect, it is largely a matter of convention as a great many things are in accounting. It is a practical way of arriving at a time at which revenues and income are recognized in the accounts, although it does not vitiate the accounting principle which seems to me to be the important one, of revenue accrues throughout the productive process. You just recognize it on the books at a certain time as a practical expedient, a matter of convention.

[fol. 137] Q. As a practical matter you don't tax it until it has been realized, either, do you, sir?

A. Generally, that is the case.

* * * * * * *

Q. Your definition, I shouldn't say definition, but your statement in respect of factors and formulae, was to the effect that you preferred two factors, payroll as one of them and property as the other. Am I correct, sir?

A. That is right.

Q. When you were using those factors and when you were discussing your preferences you were talking about revenues, were you not, sir, and not income in the sense that this Franchise Tax Act defines income?

A. I was talking about both, both gross revenues and net income.

Q. But wasn't it your statement, sir, that in your view the two factors of payroll and property more precisely arrived at the result of continued activity by the corporation

because revenue in your understanding was not an event which occurred at one instance but took place over a period of time?

A. That is right. I was speaking of allocation or apportionment of net income, of course, on the basis of these factors rather than gross revenues if that is what you mean; yes, sir.

[fol. 138] Q. You say that you give no consideration, I don't mean that literally, but that you give very limited consideration to sales. You said, as I recall it, that you did not think it would effect substantially the result but certainly you did not prefer the addition of sales to the factors of payroll and property. Why don't you give any consideration, sir, to sales?

A. For the reasons that I indicated, I think it is an extraneous element in the computation, the time of sale is simply the time at which the income is recorded on the books. The amount of the income is attributable to the other factors, the application of effort and the use of capital throughout the productive process.

Furthermore, as I indicated previously, I think the introduction of the sale tends to duplicate the factors to a certain extent because if you have payrolls and property then you include also whatever allowance is in there for payrolls and property so that you are getting a duplication, and I just thought it was unnecessary.

Q. When you just simply say an item of $5,000, an amount received as a consequence of a sale, how can you inject into that item an element of payroll and property?

A. The sale is a compensation, a recovery by the corporation, of the amount it has expended for payrolls and property, plus a profit.

Q. Then, what you are talking about, sir, substantially is [fol. 139] that you believe that costs are the proper elements to be used for the determination of an apportionment of income?

A. Precisely.

Q. And you think that the cost basis is the only proper basis for determining income?

A. I would not—

Q. I am not talking about determining in the sense of

ascertaining the amount which shall be allocated or apportioned somewhere.

A. I think the cost basis is—I would not say it is the only proper basis, probably from the standpoint of accounting theory it is the only one that is actually supportable. There may be other considerations which would make the use of anotner basis such as property and payrolls, not actual costs, a reasonable approximation of those costs. And I wouldn't say just because of that that it was improper.

Q. Are you familiar, sir, with the decision of the United States Court of Appeals for the District of Columbia Circuit in a case entitled District of Columbia versus Southern Railway Company?

A. I do not recall it. I may have heard it but I do not recall it.

Q. If I told you, sir, that the United States Court of Appeals for the District of Columbia Circuit had determined in that case that the use of costs by the District of Columbia for the purpose of determining so much of the income of the Southern Railway Company as was properly [fol. 140] subject to tax by the District of Columbia was an improper approach to the ascertainment of that income subject to tax, would your views change, sir?

A. That is a matter—

Mr. McGratty: If your Honor please, I object to that question in that—

The Court: I don't think, Mr. Wixon, that is a proper question. What difference does it make?

Mr. Wixon: I am simply asking him as an expert—

The Court: You are asking him whether or not if someone tells him about a case he will change his views. What difference does it make? If someone told him about a case it isn't worth much.

Mr. Wixon: All right.

By Mr. Wixon:

Q. Are you aware of the fact, sir, that the use of the two factor formulae that you suggest, payroll and property, so far as the District of Columbia is concerned, produces the lowest or smallest amount of tax?

A. It produces a smaller amount of tax than the use of the three factor formulae or the single sales factor formulae; yes, sir.

Q. And did that influence your judgment, sir, in your making of preferences?

[fol. 141] A. No, sir. As a matter of fact, I arrived at my conclusion before I saw the computations.

Q. In part of your testimony you stated that you matched costs against revenues. What did you mean by that, sir?

A. I meant ascertaining that the costs of producing a product are recorded at the same time within the same accounting period, for example, as the revenues which arise out of the product represented by the costs are taken into income. That is true in the case if one is dealing with periods of time. If one is dealing with a plant or a job it means getting the costs attributable to that plant for that job lined up with the revenues that arise from the products produced in the plant or on the job.

Q. Now, basically, sir, from the standpoint of accounting and consultation it is true, is it not, that you must keep close check upon your costs so that your costs bear a reasonable relationship to the total income?

A. That is the aim in any business undertaking, yes, sir.

Q. It is true in any activity, is it not, of a commercial nature, where production of income is the intention, that you are going to incur costs as a necessary concomitant of production of income?

A. That is right, all business activities have costs attaching to them.

[fol. 142] Q. Well, is there any magic, sir, in the fact that you incur costs in business?

A. Any magic?

Q. Yes, sir.

A. Well, it is an ordinary business fact of life.

Q. It is a fact which is directly related in every instance to the production of income?

A. That is right.

Q. Is that correct, sir?

A. Yes.

Q. What is the purpose in your experience of business as a general rule? I mean purpose in the sense of what is

its aim? What does it intend to accomplish? What does General Motors, for example, intend to develop or obtain as a consequence of its production and sales?

A. Well, the ordinary business enterprise is undertaken in order to make income.

Q. You spoke, sir, of the items of property and the items of payroll as having considerable significance in your view in the apportionment of income. Isn't it a fact, sir, in your experience, that without talking about the matter in the sense of a recordation of it that the costs which are incurred by a corporation such as General Motors for payroll and the costs which are incurred by General Motors for its plant and other operations generally, are all directed to [fol. 143] the conversion of one asset into another asset so that the second asset can be disposed of to the public and as a consequence of that disposal income realized?

A. They are directed towards the production of products which can be sold to the public at a profit; yes, sir.

Q. The conversion of assets from one type into another which we call generally speaking in the commercial end of the thing, costs.

. . . . . .

By Mr. Wixon:

Q. I understand your definition of revenue—and these are the notes I have, Mr. Powell, so they may be incomplete, substantially to mean the gross proceeds of sales or services after deducting returns of merchandise?

A. Allowances, trade discounts and that kind of thing, yes, sir, but before deducting costs of manufacturing, selling and whatnot.

Q. Well, as I understand it, when you use the word "gross proceeds" you mean the amount received as the consequence of a sale or the rendition of a service?

A. Received or receivable.

Q. And it could, of course, be in cash or in some other asset?

A. Such as a claim against a customer, tenant, client or other person, yes, sir.

Q. Or another vector or another boat or something of that sort?

A. Not ordinarily, but it could be.

[fol. 144] Q. It could be?

A. Yes.

Q. Now, when you use the word "revenue," then, in your testimony here, you are talking, as I understand it, about income; that is to say, about the amount received as a consequence of the rendition of a service or the sale of an item?

A. The amount received or receivable, yes, sir.

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The Court: Isn't it a fact that in cases of this kind, multistate manufacturing businesses, the general formula throughout the United States, mostly approved, is the three-factor formula?

The Witness: I believe that is so, your Honor.

The Court: Most of the states have that, don't they?

The Witness: I believe so.

* * * * * * *

Paul Studenski was called as a witness for the Petitioner and, having been first duly sworn, was examined and testified as follows:

The Court: Would you please give your full name and address to the reporter and take a seat?

The Witness: My name is Paul Studenski. I reside at 290 Avenue of the Americas in New York City.

[fol. 145] Direct examination.

By Mr. McGratty:

Q. Will you please state your occupation, sir?

A. I am an economist, specializing in public finance, tax policy, taxation methods, economics and the like subjects.

Q. Are you connected with any educational institution?

A. I am a Professor Emeritus of Economics of New York University and at the present time a research consultant to the New York State Legislative Committee on School Finance.

Q. Will you state where you received your training in your special field?

A. I received my training in economics and political science at Columbia University where I received my Doctorate degree forty years ago in 1921. I received my academic training also in several other academic institutions, universities, in this country and abroad and I also received my early training in the fields which I have mentioned as a member of the research staff and director of the research staff for several research institutions, national and state, during the period of 1914 to 1926, when I was connected with them.

Q. Have you done any teaching in your special fields?

A. I have taught economics, public finance, public financial administration, national income analysis in New York University on a graduate level for close to thirty years and also as a visiting professor and lecturer in other in- [fol. 146] stitutions of higher learning.

Q. Have you served in an advisory capacity to any federal or state agencies?

A. I have served as a consultant to several federal agencies including the United States Bureau of the Budget, the Social Security Board, the U.S. Public Health Office, and I have served as a consultant to a number of state commissions, in New York State, including for over a period of about seven years as a research director on tax matters for the New York State Committee on the revision of the tax laws of the State; I served as senior fiscal consultant to the Constitutional Revision Commission of the State of New York in 1938, and again in 1958 to April 1 of 1961.

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Q. Have you written any books or articles?

A. I have written several books in the field of public finance, taxation and economic national income analyses, including—I mean among the latest ones, a book on taxation and public policy, a book on the financial history of the United States, and the latest one is the book called, "The Income of Nations."

Q. Have you written any articles for economic or political publications or periodicals?

A. Oh, I have written a very large number of articles on these subjects during the past forty-odd years which have appeared in various professional and scientific journals.

Q. Have you made any special study of state corporation [fol. 147] income taxes?

A. During the past three and a half years I have made special studies of the state taxation of corporate net income arising in interstate commerce. I have written articles on this subject which have appeared, substantial articles in the Harvard Business Review of October 1958, another one in the Harvard Business Review two years later, October-November 1960; a large article in the Virginia Law Review which appeared in November-December 1960.

I presented a paper on this subject before the National Tax Association in 1959, and published also articles on the subject in the Tax Review and presented testimony to the Senate Committee on Small Business when it had under its consideration in the spring of 1959 the preparation of a bill calling for the establishment of certain Federal standards for the imposition of state taxes on corporate net income arising in interstate commerce.

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Q. I ask you if you have familiarized yourself or have you examined the District of Columbia Income and Franchise Tax Act of 1947?

A. I have.

Q. Do you have in mind that provision of the statute which states—

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Q. (Continuing) —that states the measure of the franchise tax shall be that portion of the net income of the [fol. 148] corporation and unincorporated business as is fairly attributable to any trade or business carried on or engaged in within the District?

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The Witness: I am familiar with that phrase in that law.

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Q. Would you state in what sense you yourself use and mean the term "fairly attributable"?

A. I have used this term "fairly attributable" in the sense of meaning an approximation of the amount of in-

come attributable to business activity in a given jurisdiction, as an approximation arrived at by the most reasonable and practicable methods and use of the best available data, being aware of the fact that a precise, completely precise, expression or measurement of the income attributable to activity in a given jurisdiction is impossible in view of the great complexities of the underlying matters.

The Court: So hereafter when he refers to that term that is what he means.

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By Mr. McGratty:

Q. Professor Studenski, did you hear the hypothetical question which I yesterday addressed to Professor Paton and which I again read into the record this morning and do you have in mind the facts set forth by me in that hypothetical question?

A. I have heard the hypothetical question, listened to it most attentively, and have taken notes of the salient facts related in that hypothetical.

[fol. 149] Q. Now, Professor, have you read and do you have in mind paragraphs 9 and 10 of the supplemental stipulation which is Petitioner's Exhibit 6 in this case?

A. I have read those paragraphs and I have them in mind.

Q. Now, on the basis of the same facts and figures contained in that hypothetical question and in paragraphs 9 and 10 of Petitioner's Exhibit 6, and which facts and figures I now ask you to assume to be correct, do you have an opinion as to whether the sum of $5,156,525 represented the approximate portion of the total net income of General Motors fairly attributable to the business carried on by General Motors in the District of Columbia in the year 1957—

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Mr. McGratty: And if I may continue the balance of the question—

By Mr. McGratty:

Q. And whether the sum of $2,707,677 represented the approximate portion of the total net income of General Motors fairly attributable to the business carried on by General Motors in the District of Columbia in 1958?

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The Witness: I have an opinion on that subject.

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[fol. 150] Q. What is that opinion?

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The Witness: I consider that the amounts cited are in line with the facts and other figures presented in the exhibit which I have in my hand, that these figures do not represent a fair apportionment to the District of the portion of the total net income of the company attributable to business conducted by the company in the District.

The Court: Well, the law says fairly attributable?

The Witness: Fairly attributable, I beg your pardon.

The Court: Do you change your testimony?

The Witness: No, I want to change it to the terms "fairly attributable." I regret the inexactness of my expression.

By Mr. McGratty:

Q. Now, Professor Studenski, in your opinion how is the portion of the net income fairly attributable to the business activity carried on by the General Motors Corporation within the District of Columbia properly to be determined?

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The Witness: In my opinion the portion of the company's total net income fairly attributable to its activities in the District of Columbia should be arrived at by taking into account all of the net income producing activities of the company as conducted in the District in relation to the [fol. 151] total income producing activities of the company everywhere.

This means that every aspect of the company's activities which contributes to its income should be considered as a relation of the one conducted in the District to the

activity conducted elsewhere. That is, that the manufacturing activity, if any, conducted in the District, should be considered to the manufacturing activity conducted elsewhere, or if manufacturing activity is not conducted by the company, as in this instance, then its absence should be considered in the allocation of income just as much as the presence of any other income producing activities of the company are considered is conducted in the District and as conducted everywhere. The warehousing, selling activity, the processing of orders; every activity, financing, general administration—every activity of the company which contributes to the income should be considered as a proportion conducted in the District of the total of it conducted everywhere.

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Q. Are there any factors common to all of the various income producing activities to which you refer?

A. Two factors are common to all the income-producing activities of the General Motors Corporation as well as of any other business enterprise. These two factors are: the capital and labor, including management, employed in the conduct of that activity, because it is capital and labor em- [fol. 152] bodied in any business activity that are sources, that are the creators, of the income of the General Motors Corporation, as well as of any business enterprise.

The activity is productive of income to the extent that capital and labor are employed—including management—in the activity, and it is upon the effective combination of capital and labor in the conduct of a business enterprise, and that applies to the General Motors Corporation, that a realization of net income depends.

By Mr. McGratty:

Q. How, as a practical matter, can these two common factors which you refer to be used to determine the portion of the total net income of General Motors which is fairly attributable to the business carried on by that corporation within the District of Columbia?

A. By taking the proportion of the property of the company, which is a matter of capital, employed in the Dis-

trict, to the total property employed by the company anywhere, everywhere, and by taking the proportion of the payroll which is a measure of the value of labor and management's efforts in the activities of the company in taking the proportion of the payroll which is maintained in the District to the total payroll maintained by company everywhere.

Q. In your opinion what relevance have District sales in the determination of the portion of the total net income fairly attributable to the business carried on by General Motors Corporation within the District?

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[fol. 153] The Witness: In my opinion sales, as such, without taking into account the amount of selling effort, of the labor and management effort, and of the capital involved in the production of the sales, and without reference to the other income producing activities of the company—

The Court: No, he didn't ask you that. He wanted to know what consideration you would give to sales in arriving at any formula?

The Witness: Sales, as such, in my judgment, are not relevant to the determination of the portion of the company's income allocable to a given jurisdiction.

I should like to qualify that if I may be permitted, by saying that to the extent to which sales involve a selling effort in the jurisdiction where the sales are located, I attribute a very great importance to the sales insofar as that is involved.

The Court: But do you think that should be reflected by the payroll factor?

The Witness: They would be, obviously, reflected by payroll and by the property factor.

The Court: Yes. But you wouldn't give sales itself any consideration at all? You don't think sales produce any income at all?

The Witness: Not unless there is a selling effort involving capital and labor, but I would not attribute to sales an independent place of payroll and property in their allocation of income.

[fol. 154]

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The Witness: I would like to in view of the question —I would not allocate—excuse me, I would not allow an independent place to either sales by destination or sales by origin of the shipments in the fair allocation of income. I would only allow for the factors of property and payroll.

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Q. Professor Studenski, would you now state the reasons for that opinion?

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The Witness: Well, in my opinion the amount that is allocated to the District is greater, considerably greater, than the amount which can be fairly attributed to activity conducted by the company in the District. The amount is based upon the proportion of the sales of the company effected in the District in relation to total sales and in my opinion the proportion of the sales effected are not an indication of the corresponding proportion of net income earned by the company in the District.

My reasons for that are that, first of all, the sales effected in the District by the company are in part the result of the efforts of the dealers who are independent operators, that they are in part the result of the choices, habits, preferences, of the consuming public in the District, over which [fol. 155] neither company nor the dealers have much, if any, control.

My further reason is that the activities of the company which led to the sales in the District are conducted by the company in other states, that these activities which result in the sale consist of the production of a product of a good quality at an acceptable expected price, consist of merchandising activities which are conducted, at least in part, outside of the District, consist of a multiplicity of operations of the company in the whole productive and marketing process which are conducted outside of the District.

It is true that when a product, a car or other product of the company, is sold in the District a certain amount of profit is obtained, a certain dollar amount of profit is obtained, but this dollar amount of profit is not obtained

through the final sale of the product alone, and through the effort made, but through all of these other processes of the company which precede the act of sale that each one of these operations contributes some proportion, proportions are variable, to the profit obtained by the company from the sale of the product in the District, and that, therefore, the location of that entire profit from the sale of the product—I would say from the production and from the sale of the product, the attribution of that entire profit to the District in which this sale is made is, in my judgment, not correct.

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[fol. 156]

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Q. Just one preliminary little question, Professor Studenski.

During the course of your testimony this morning you referred to an exhibit or to a copy of an exhibit which you said you were holding in your hand.

Is this the exhibit to which you referred?

(Handing document to the witness.)

The Court: Is that marked?

Mr. McGratty: It is Petitioner's Exhibit 7a for identification.

(The document referred to was marked Petitioner's Exhibit 7a for identification.)

The Court: I just wanted the record to show what you were referring to. All right.

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Did you hold a copy of that in your hand?

The Witness: As far as I am able to identify the figures which I quoted from the paper which I had indicate that this is the identical, the statement which I have held, is identical to this exhibit which is marked—

Mr. McGratty: Petitioner's Exhibit 7a for identification.

The Court: All right; that is the answer.

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[fol. 157] By Mr. McGratty:

Q. Professor Studenski, what is your opinion with respect to the view sometimes advanced that it is the consumer who furnishes the profit to the manufacturer and that the entire net income of the manufacturer is therefore attributable to the state in which he sells his products?

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The Witness: Well, my opinion is that it is the wrong argument and I should like to—I think I could express—

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Q. Would you state, Professor Studenski, as concisely as you can, the reason for the opinion which you have expressed?

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The Witness: Can I give the reason by quoting a brief passage, a brief paragraph from the article which I wrote which appeared in the Virginia Law Review of October-November of 1960?

The Court: If it expresses your opinion, yes.

The Witness: That expresses my opinion.

The Court: Go ahead and do it.

The Witness: (Quoting) "The argument that the consumer furnishes a profit to the out of state producer and therefore the consumer's state is entitled to tax the producer's profit is fallacious. It flies in the face of the most elementary facts of economics. The consumer furnishes to the producer not a profit but the money out of which the [fol. 158] producer gets his profit and that money is the price which the consumer pays to the producer for goods he purchases. The profit is produced not by the efforts of the consumer but by those of the producer. If the consumer had his way the producer would get no profit. The consumer does not confer any benefit upon the producer for which he does not receive an equivalent benefit.

"Each benefits the other no more than he is benefited by the other. The fact that the out of state producer earns a profit from the sale, per se, does not give to the state of the consumer the right to tax the producer's profit. The whole theory of benefit conferred by the consumer on the

out of state producer as a basis for taxing the latter on his net income represents a most extraordinary combination of irrelevant and misleading propositions, lacking either rhyme or reason."

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By Mr. McGratty:

Q. Professor Studenski, will you express your opinion with respect to the viewpoint which has been and is sometimes advanced that the state where the customer resides furnishes services which from an economic standpoint justify that state in taxing a portion of the net income of the corporation?

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The Witness: I am aware of that argument. It is my opinion that the state of the customer renders services to the out of state producer who sells goods in the state to the [fol. 159] extent to which the out of state producer conducts activities, business activities, in that state by using some of its property and using some of its labor in that state.

Manifestly, where the state—I mean, in my judgment, the services rendered by the state are ordinarily related to the amount of activity, to the amount of property, to the amount of payroll, used by the out of state producer in the state, but the services in my judgment in that case, are not as extensive as are the services rendered by the state in which the out of state producer conducts his manufacturing and other productive activities distinct from the selling activity conducted in the state of the customer.

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Q. If a state taxes a portion of the net income of an out-of-state producer which is not proportionate to the business carried on by that out-of-state producer in the taxing state, what, in your opinion, is the economic consequence?

Mr. Wixon: Objection. It is an argument, if your Honor please, on proprieties, perhaps, of taxation, not the legalities of it.

Mr. McGratty: If your Honor please, I have not asked with respect to the propriety or legality, I have asked this

witness solely what his opinion is with respect to the economic consequences. That is a matter of opinion.

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[fol. 160] The Court: Go ahead. I will overrule the objection to save time. I do not think it is at all helpful, but what is your answer to that question?

If a state taxes more than it should on the basis of activities in the state, what do you think is the effect of it?

The Witness: The economic effect is that the state which imposes a tax in excess of the amount which is proportionate to the activities conducted by it is for that state to tax some of the income originating in the state or states in which that out of state producer conducts his manufacturing and other activities which income, in my judgment, or portion of the income, in my judgment, is a proper subject of taxation in that state in which the out of state producer conducts his manufacturing and other activities.

In my judgment, by taxing in that way the out-of-state producer disproportionately, the state adds to the already great, much too great, confusion in the manner of imposition of taxes on corporate net income by states and opens more widely the possibilities for double and multiple taxation of the producers, thereby interfering with the freedom of the producers, thereby interfering with the freedom of the producers to function effectively in interstate commerce.

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The Witness: Yes. And if I may add one more thing, that thereby the state, in my judgment, harms the national [fol. 161] economy because the freedom of interstate commerce is so essential to the prosperity of the national economy, it has been the foundation for the growth and prosperity of the national economy.

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Cross examination.

By Mr. Wixon:

Q. Professor Studenski, I understand you to say that so far as you are concerned, two elements should be taken into account in determining the amount of income which is

to be apportioned to a jurisdiction for tax purposes—capital and labor. Am I correct, sir?

A. Yes.

Q. Now, by capital you mean what, sir?

A. Property.

Q. You mean property in the physical sense?

A. In the physical sense, the value of the property obviously.

Q. Well, now, capital is employed in such things as inventory, is it not, sir?

A. That would be included, I would consider inventories as a part of the property of the company.

Q. And you would consider all assets of the corporation as property? All assets?

A. This brings me into the field of accounting, the very [fol. 162] use of the term "assets," which I would prefer not to use because assets is an accounting term and I am very humble about it as I understand it includes accounts receivable and things of that sort, and I would be hesitant in including that in my concept of capital.

Q. Well, would you then limit it, sir, to personal and real property of a taxable nature?

A. I would—personal and—well, I would include besides personal—well, personal—no besides personal taxable property I would include the investments of the company in stocks and bonds, but at the same time I would recognize the difficulties which would be involved in the allocation of these investments.

Q. But you would agree, sir, would you not, that capital is the totality of the investments of the corporation, whatever form those investments may take, in the operations of the company or the business, for the purpose of in turn producing income?

A. Yes.

Q. And therefore you would agree, would you not, sir, that it would necessarily include all properties of the corporation, whether they were real properties, tangible personal properties, or intangible personal type properties?

A. Yes.

Q. And that would, therefore, include notes receivable, [fol. 163] accounts receivable, any evidences of debts, bonds,

for example, any other types of assets of any kind which are owned by the corporation?

A. I would, with some qualifications as to such things as accounts receivable.

Q. Why would you limit accounts receivable in this matter, sir?

A. I am not certain as to whether that could be considered as the investments of the company and the capital of the company. I would have to think this matter through before answering that question in a competent manner, I confess.

Q. You are speaking now, sir, I take it, of accounts receivable?

A. That is right.

Q. But you have no problems, I take it, with bonds and notes and other evidences of indebtedness?

A. That is right.

Q. Now, usually speaking, Professor, is it not a fact that when a corporation invests its money in bonds or in other evidences of indebtedness that it is not employing its capital for the purpose of producing income in direct relationship to its ordinary and regular business activity, but it is using idle capital for the purpose of getting income which it may employ in its ordinary business activity?

I am talking in the commercial sense now, sir, not a [fol. 164] corporation which has as its purpose the acquisition of bonds and notes for the purpose of obtaining income. You understand the differentiation I made?

A. I understand. That is an incidental operation—the company has surplus funds and it cannot allow them to lie idle and it becomes a part of the company's activities in earning and income.

Q. Would you say, sir, following your line of testimony further, that you would not include in your property element for purposes of the particular taxing division, any bonds which were not the bonds of the taxing jurisdiction?

That is to say, that if the corporation owned bonds of the United States Government and owned no bonds of the taxing state, that you would give the taxing state no credit whatsoever for the investment in property in U.S. bonds since they were not employed in the State?

A. I may not understand your question.

If your question is whether I would recognize as part of the capital of the corporation bonds not issued by the jurisdiction in which the company operates I would say I certainly would admit any bonds, whether they are of any state or whether they are of any foreign country, so long as they are bonds which are marketable and which have value.

Q. Let me carry this out, sir, if you will bear with me.

We will assume that the General Motors Corporation has a total asset position, property position, but we will exclude now accounts receivable following your exclusion, $100 million.

[fol. 165] That $100 million consists in plants, work in process, vehicles which are manufactured by this particular corporation, and all other assets, to a total of fifty millions of dollars. The remaining fifty millions of dollars represent an investment in United States bonds, interest bearing bonds.

In your employment of the property factor what assignment of that property, in total, as represented by the bonds, would you make to a taxing state, wherever that state might be? Would you make it, for example, only to the state of incorporation of this particular business or would you have some method of allocating those bonds among the several taxing jurisdictions in which the corporation does its business?

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The Witness: I would be inclined to apportion this capital in the form of United States bonds, let us say, among the states in proportion to the property and payroll employed by the company in various states in which the company operates because the alternative of allocating it to the state where the company keeps these bonds in the vaults of its bank of deposit would produce an inequitable result.

By Mr. Wixon:

Q. Now, sir, let us take the situation that I gave you, $100 million total assets, of which $50 million represents investments in United States bonds and fifty million dollars of

[fol. 166] the total of $100 million represents work in process. The work in process is located in only one taxing jurisdiction, but the corporation does business in let us say, 26. That, as I understand it, is one of your items of capital.

How would you treat the work in process of thirty millions of dollars when you determine the element of a formula based upon capital and labor?

Where would you assign it, how would you treat it; what effect would you give to it in respect of the various taxing jurisdictions, including the one where all of this work in process is located?

A. I interpret work in process as meaning goods, unfinished goods, semi-manufactured, raw materials, and so forth.

Q. Yes, sir; I should have said that. When I use the term work in "process" I mean work or rather items which are in the process of fabrication or manufacture but are not completed. I do not use the word "work" in process to mean stockpiled materials which are not being worked upon or in any way involved in the manufacture at the moment.

I exclude those, such as pieces of iron or tin in a stockpile. Do you understand me, sir?

A. I do. I would allocate it to the state where these unfinished products are located.

Q. I believe you testified in effect that if there is no capital employed in a taxing jurisdiction and if there is no labor [fol. 167] employed in that jurisdiction, then following the concept of the two elements of capital and labor as the predicate for determining the amount of income which shall be subjected to tax there cannot be any tax for the simple reason that there cannot be any income?

A. There cannot be any tax on the net income of the company; there can be other taxes imposed on the company.

The Court: That is what he is talking about, net income or taxes based upon net income.

Mr. Wixon: We are not talking about property taxes, sir, personal property taxes, or real property taxes, of course; we are talking about income type taxes.

The Witness: Even income type I would make a distinction between a tax on net income and gross income.

My answer in the case of a tax on gross income would be very different from that posed in the case of a tax on net income.

By Mr. Wixon:

Q. Are you making a legal differentiation, sir, between a gross income type tax and a net income type tax; that is to say, a legal distinction?

A. No, strictly an economic distinction.

Q. You would agree, sir, would you not, that income is derived in our little hypothetical example, otherwise we have nothing to talk about, in the jurisdiction where neither [fol. 168] capital nor labor is performed?

You will agree that there was income resulting from some activity in the taxing jurisdiction?

A. Where there is no capital or labor employed there is no income in my judgment created in that jurisdiction.

Q. Now, sir, let me ask you if you make a distinction between the word "revenue" and the word "income"?

A. I don't use the word "revenue", I use the word "income" and "gross income" and "net income".

Q. You, I believe, were here when the other gentlemen were testifying in this case, Professor Paton, Mr. Powell, just previous to your appearance on the stand?

A. Yes.

Q. If my recollection serves me, do you recall that both of those gentlemen made a distinction between income and revenue, and as I recall it further, their distinction between revenue and income was that revenue, generally speaking in the economic sense, is a continuing process resulting from the application of capital and labor, whereas income is the ultimate result of the totality of those activities consummated through a sale or other transaction whereby title to a product on the one hand or the doing of a service on the other, results in the obtaining of an asset, usually cash.

[fol. 169] The Court: Now, what is your question after that explanation?

Mr. Wixon: I asked him if he heard that testimony, and if he agreed that that was the substance of it.

The Court: Don't double it up. Let's ask him first whether he heard the testimony.

Did you hear such testimony?

The Witness: I heard it.

The Court: Now he wants to know whether you agree with it.

Mr. McGratty: If your Honor please, I object to that question on the ground that I do not think it accurately summarizes the testimony of Professor Paton and Mr. Powell.

The Court: The witness thinks it does. He asked the witness did he hear such testimony and he said he did.

Now, what are you going to do about it? If it did not happen then the witness is wrong, but he answered that he heard it. That is all that was here, isn't it?

Mr. McGratty: The witness used such words, yes, your Honor.

The Court: Yes, sir.

The Witness: I heard it but I am not clear as to the nature of the distinction drawn, and not being an accountant, [fol. 170] I would not want to venture into the particular bases of distinction which those witnesses made.

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Q. As an economist, what is income, in your thinking, sir?

A. Net income or income—income is obviously the monies, total monies received during a given period of time by an entity engaged in business or for that matter by a governmental entity which operates. It is the total money received during the given period as a result of its activities. Net income is, of course, the difference between the income receivable during the period and the costs incurred during the period.

By Mr. Wixon:

Q. Essentially what you are saying, Doctor, as I understand it, the definition of gross income and the definition of net income usually contained in tax statutes, of course, they may vary in their meanings but they are substantially the same?

A. I would not dare to say it is the one usually expressed in taxing statutes but I would say that it is in the economic literature.

Q. Now back to our problem.

What income would you suggest would be taxable in a jurisdiction where neither capital nor labor are employed but where as a consequence of the movement of goods there is the realization of income; that is to say, that a customer in the taxing jurisdiction purchases an article of the [fol. 171] corporation for which he pays a sum of money which exceeds the cost to the company of the product so sold and results, ultimately, in net income or income, sir, as you used it?

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The Witness: Where the company realizes a gross income, gross receipts, I would consider that tax by the jurisdiction on the gross receipts realized by the company in this state is a proper basis for the imposition of the tax. Where there is no net income realized by the company because there is no property and labor employed in it, I would consider merely the effectuation of a sale or an act of sale. I would consider that the application of a net income tax is not an equitable application.

By Mr. Wixon:

Q. What would you do in the case of a state which had such a tax as a matter of law? Would you assign any income to that state to be subject to tax? Where there was neither capital nor labor employed?

A. I cannot conceive of the existence of a state in which no enterprise exists employing capital and labor and therefore earning net income in that state.

Q. Well, you will agree, will you not, that income is realized ultimately through the sale of a product or the rendition of a service for which compensation is paid in one form or another. You will agree with that proposition, will you not, sir?

[fol. 172] A. That gross income is realized. Your question refers to gross income or net income?

Q. Both. Gross income and net income.

A. Well, I would make the distinction, I would say that gross income is realized when the sale is effectuated in the state, but I would say that net income is not necessarily

realized, it is not realized if there is only an act of sale where the negotiation of the sale takes place somewhere else, not in the state, and none of the productive and marketing activities of the company carried on with the state through the employment of the company's employees and of any of the company's property.

Q. Well, isn't that tantamount to saying, sir, that all of the income is net income? Since if there is no capital and no labor there must be an entirety of net income, not gross income?

A. I don't—will you kindly rephrase that?

Q. Yes, sir. Let me do this: I get from you the impression that you regard net income as having been obtained only in the event there is a cost involved in the transaction which gave rise to the gross income?

A. I did not say anything about the cost incurred. I said only where capital and labor, including management, are employed, where there is the contribution of capital and the effort of labor and management. I did not say anything about costs incurred.

[fol. 173] Q. But what is, then, net income, sir? What is net income, in your view?

A. Net income is the result of the total operations of the company. It is the result of the relation of its gross income and the costs incurred attributable to that period. This is the net income, the result of the efforts all the way through from beginning to end.

Q. It is in essence, is it not, sir, the proceeds derived from sales of merchandise on the one hand or the rendition of services on the other, which we term gross income, and from which we deduct all the expenses incurred, either in the activity which gave rise to the sale of the product or the activities which were required in connection with the rendition of the services?

A. The net income or the profit is anticipated by the company and controls every operation of the company. Every operation of the company is conducted in terms of the contribution which is likely to be made to the production of the profits. That is an estimated profit and if a particular operation according to the management is not likely to pay for itself and to contribute to that eventual net income or

net profit, then the management must not venture and ordinarily does not venture upon such an operation.

In other words, net income is earned by every operation, manufacturing, or whatnot, every operation contributes to the production of that net income, that ultimate result.

[fol. 174]

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Mr. Wixon: Isn't net income, sir, the difference between gross income and the expenses of carrying on the business? Isn't that net income?

The Court: Can you say Yes or No to that?

The Witness: Yes, but the expenses are incurred all the way through.

Mr. Wixon: I did not ask that.

The Court: I think we will be here until tomorrow some time if you keep on embroidering your answers. He merely asked you whether net income was not the gross income less the expenses of operation.

The Witness: Yes.

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By Mr. Wixon:

Q. Now, you stated that a jurisdiction in which the corporation we are talking about employed neither capital nor labor could impose a gross income type tax, but I understood you to say that in your view it could not impose a net income tax?

A. Yes, where there is no capital and labor employed.

Q. Yes, sir. Now I asked you, I don't think you responded —I asked you what would be your approach to determining [fol. 175] the amount of income to be subjected to tax in a state which had a tax on net income but in which the corporation we are talking about did not employ capital or labor?

The Court: He says no tax at all, Mr. Wixon.

The Witness: I said no tax.

Mr. Wixon: I simply asked him how he would do it. You say it could not be done?

The Witness: I would not—

Mr. Wixon: I see. I understand.

By Mr. Wixon:

Q. What would your view be if all of the sales of the merchandise manufactured by this corporation occurred in the state which had such a type of tax, although, again, neither capital nor labor were employed in that state?

A. That state, in my judgment, should not tax the net income of the corporation, if the sales, the acts of sale take place but no selling activity or any other income producing activity involving capital and labor.

Q. Now, one question, sir.

We have one person in the taxing jurisdiction employed by this corporation; he is a salesman, and the entire product of this corporation is sold in that particular jurisdiction through that single salesman, but all other property, capital if you will, and labor is outside the taxing jurisdiction. [fol. 176] What would be your approach in that case to an ascertainment of the net income subject to tax?

A. My approach would be that the state theoretically could tax the company's net income in proportion to the commission or salary which that representative receives from the company for his activities in the state, to the total payroll of the company, plus the total property, none of which is present in the District—

Q. We are not talking about the District, now, sir.

A. Excuse me—in the state. But that as a practical matter, I would consider it exceedingly unwise for the states in which there is very little capital and payroll employed by out of state producers to tax the net income of these out of state producers on that small amount proportionately to the small amount of property and payroll employed in it.

Q. This example I will make up, sir.

If the total capital of this corporation we have been talking about, the one with the one salesman in the jurisdiction, the total capital was five million dollars and the total labor costs were five million dollars, and the total compensation of the single salesman was $10,000 per year, and if in that single year for which this salesman got $10,000 compensation that corporation sold five millions of dollars of goods, that is the net income from those, what would be the amount of tax which, on your approach of capital and labor, the

taxing jurisdiction which we are using in our example would be entitled to receive?

[fol. 177] The Court: You mean what proportion of net income would be taxed?

Mr. Wixon: What proportion of net income would be taxed?

The Witness: The proportion of net income would be infinitesimal and so would be the tax, and, therefore, in my judgment, the state should not undertake the imposition of net income taxes on companies which have very small amounts of property and payroll in them, even though they have extensive sales.

In my judgment it is an imposition on the company, it is an interference with interstate commerce, and I am speaking here as a student of public finance if you will pardon me. That is my position.

By Mr. Wixon:

Q. Well, you will agree, sir, that without a market for your goods you can produce from dawn to dusk and make no profit? You will concede that, sir?

A. Yes.

Q. Now, if this particular taxing jurisdiction supplies the entire market for the commodities manufactured by this corporation, is that fact without any weight in the determination of the tax or the amount of income I should say, which may be subjected to tax by the jurisdiction which is the sole market?

Is that the fact, no influence at all?

[fol. 178] A. I would like you to repeat that question.

Q. I would be happy to.

If this particular jurisdiction is the place for the sole marketing of the production of the company we are talking about—

Q. (Continuing) —the sole market now, sir?

A. Yes.

Q. Although there is no capital or labor in that particular jurisdiction with the exception of the one salesman, does not the fact that without the market there would be no sale

of the goods influence to some degree your judgment in respect of the amount of income which the taxing jurisdiction we are using ought to be able to subject to tax?

A. Well, this is an extreme position which you have drawn.

The Court: That is the acid test.

The Witness: That is the acid test. Yes, that is the acid test. I realized that. I better not indulge, any proposition can be brought to ridicule by the reduction to the absurd.

By Mr. Wixon:

Q. Excuse me just a moment. We would have sales of proportionate amounts, any amount you want to take and the proposition would come out the same, would it not?

A. Well, if it is a substantial corporation such as you have cited, the imposition of the—I may be influenced in the way of saying that is not theoretical but also a practical proposition, the imposition of a tax on that company on [fol. 179] the proposed small amount of net income attributable to the presence of that one representative would be justifiable, it would not be too much of a burden on interstate commerce, but I would still think that if situations of this sort in the state would be quite general in nature of corporations selling but having everything outside then the state should better look to another type of tax than a net income tax which would equitably produce to it a substantial amount of revenue.

By Mr. Wixon:

Q. Would a gross income tax make things any better, Dr. Studenski?

A. It would.

Q. You say it would make things better if it was a gross income tax?

A. Yes.

Q. Let me ask you, sir, as an economist, isn't it in your experience in taxing matters, isn't it a fact that goods coming into competition with goods in the taxing jurisdic-

tion all suffer the same types of disabilities in this sense, that each should bear their own share of the costs of administration of the government because the activity which gives rise to the income of the one corporation is the same activity which gives rise to the income of the other? That is to say, the sale of merchandise?

[fol. 180] A. Well, I have already put it on the record that I believe that the services rendered by the State bear some proportion to the activities conducted by the enterprise in the state through the use of property and labor, that the greater the property and labor employed by an enterprise in the state the greater normally would be the values, services rendered by the state to the enterprise, and that, therefore, the tax imposed on the corporation on its net income should be related to it.

Now, where there are only sales, without selling activity, it is a very important distinction that the sale is the result of a selling effort and not the selling effort itself. So that there, where there are only sales, no matter how extensive they are, if they are through merely shipping of goods through the facility of the railroad to customers, or what, but where there is no activity represented by capital and labor, in my judgment there should be no imposition of a tax.

Q. I understood you to say, Professor Studenski, that so far as sales were concerned, and I believe you had in mind General Motors, that it was the dealer on the one hand and the buying public on the other which caused sales to be made of this merchandise and that, in fact, since it was the dealer and the public you should not give any consideration to sales?

A. Are you speaking about—

[fol. 181] Q. Your testimony.

A. (Continuing) —the sales to the dealer by the company?

Q. Well, I don't speak in either sense, sir. I understood you to say that the two-factor formula, capital and labor, was the only proper formula to use, and that you gave no regard to sales for the very obvious reasons that sales were the consequence of the production by General Motors of an excellent product which appealed to the public

and therefore the public was the one that was making, so to speak, the sales—

The Court: No, he just said the opposite.

Mr. Wixon: Just a minute, sir. I would like to go back in the transcript, I am going on recollection and notes.

By Mr. Wixon:

Q. (Continuing) —but that the demand of the public for General Motors' products on the one hand, together with the activities of dealers in General Motors' products on the other, were the two things that caused the sales?

A. No, I made no such statement that these are the only two things. I made a clear statement according to my recollection that all the activities of the company precedent to the act of sale involving the manufacturing of the goods, the development of the marketing policies and program of the out of state producer or out of District producer, [fol. 182] that all of these factors contribute to the consummation of the sale. But they happen to be carried on outside of the state in which the act of sale is finally consummated.

By Mr. Wixon:

Q. Well, what state are you speaking of, sir, any one?

A. The District, excuse me, the District.

Q. Is it your understanding of the facts that there is no advertising by General Motors in the District of Columbia, that there is no activity of selling in the District of Columbia by General Motors, that there are no officers or agents of General Motors in the District of Columbia? Is that your understanding?

A. No; if you ask me about the conditions present in this case, of course there is selling activity by the company in the District. There is, of course, and to that extent I recognize the justification for the District of imposing a tax on the net income of the company.

Q. But you would base it entirely upon capital and labor employed in the District of Columbia without relation to sales?

A. Yes.

Q. Now, I also heard you say, sir, in speaking of the impropriety of involving sales in a formula, I made a note, I hope you will tell me if I incorrectly made the note—that there was advertising involved in the selling of these products of General Motors and that the three factors or items [fol. 183] of advertising, public choice, and dealer activity, were in essence the activities or the items which resulted in sales of General Motors products?

A. Yes.

* * * * * * *

Q. Tell me, sir, do you, as did the other gentlemen who testified here, take the position basically that costs are the dominant item in the determination of a factor for apportionment of income for tax purposes?

* * * * * * *

Q. Costs of the activities of the corporation, over-all; that is to say, the costs of labor, the costs of the manufacture of the particular products which are being sold; the costs of advertising, the costs of keeping records and books, that is to say, the items of paper, pencils, all those things, that those are the basic items which are to be considered when you determine what jurisdiction is going to have a tax? Costs in that jurisdiction are the thing.

* * * * * * *

The Witness: The costs of capital and labor employed in the jurisdiction, yes, have a very vital bearing.

The Court: Now, is that as far as you go on costs?

The Witness: Well, the costs have to be related to the income and the costs of capital and labor in the different jurisdictions are the creators of the income.

[fol. 184] The Court: No; he did not ask you that. This is a simple question. These men have testified that the principal things to consider are costs—both of them. You apparently from your testimony don't agree with that.

Mr. Wixon: I think he said he did agree.

The Court: No, he does not really. He has left out the most important cost of all, and I can't understand why none

of them have ever dealt with it, but I will come to it in a minute.

By Mr. Wixon:

Q. Let me ask you this, sir. You have costs incurred in production. We are talking about General Motors. We might just as well use General Motors.

General Motors incurs costs in manufacturing its product which it sells, it has costs for its raw materials, it has overhead costs.

Do you want me to define what I am speaking of when I use overhead?

A. Yes.

Q. You would like to have that?

A. Yes.

Q. Overhead in my use of it here, for our purposes, consists of all those costs which are not directly related to production. That would be, for example, the Accounting [fol. 185] office of General Motors, the legal fee or rather the legal costs or fees which are paid to defend or bring suits; those which do not directly relate themselves to production, the making of something. That is my use of the word "overhead." I am not trying to draw it finely, I am just trying to make a broad statement of it.

Q. You have overhead costs. You have advertising costs; you do not need me to define advertising, sir, you know what I mean by that, taking advertisements in the newspaper?

A. Yes.

Q. You have radio advertising and all kinds of miscellaneous costs or expenses which are all directed to ultimate production of income.

Now, in your view are those costs basically the primary item or items which determine or should be used to determine the amount of income which is to be subjected to tax in a taxing jurisdiction?

A. The costs of capital and labor employed in the jurisdiction are in my judgment the basis on which one can attribute properly the income to the jurisdiction.

I would not go as far as to include all costs.

The Court: He has repeated it and repeated it.

By Mr. Wixon:

Q. All right, sir; what costs would you exclude?

[fol. 186] The Court: He would exclude all other costs. He said labor and capital.

By Mr. Wixon:

Q. All right, sir, what other costs are you excluding? What items do you mean by you would not include all costs?

A. Well, you may have the costs of raw material, the purchases of raw material in a given jurisdiction and that in itself, in my judgment, does not represent a proper basis for the allocation of income to that jurisdiction.

Q. But inventory is not cost, is it, sir?

Raw materials are not costs in the sense of expenses?

A. Well, raw material, I said in the sense of purchases of raw materials in a given jurisdiction.

Q. It is an asset?

A. The purchases, you say costs and I am saying that the purchases of raw materials in a given jurisdiction, the incurring of costs for that purpose does not determine the location of the net income properly attributable to that jurisdiction.

The Court: Your theory is that where they are employed, the jurisdiction in which the property is employed, isn't it?

The Witness: Yes, the property, but the employment of the property, it may be small property but it may be a purchase of very extensive raw materials.

[fol. 187] The Court: That is right, but the jurisdiction in which the physical property is employed is where it determines?

The Witness: Yes.

The Court: Buy lumber in Wisconsin and it is used in Michigan and it will be Michigan where it comes to rest?

The Witness: That is right.

The Court: I see. You would not assign any income to Wisconsin because you happened to buy some lumber there, that is what you mean?

The Witness: That is right, exactly; I am sorry, we are dealing with very confusing matters and I regret if I am not making my answers clear enough. I apologize.

The Court: Mr. Wixon has asked you what do you eliminate, what sort of costs would you eliminate?

Mr. Wixon: Expenses, I said.

As I remember it, you have costs of getting this thing or these things manufactured and I used the word costs in the sense of the expenses of doing it, not just going out and buying something, sir, to put off on the side.

That is not a cost that I am talking about; I am talking about expenses, the costs of getting all these things done.

Do you see what I am driving at, sir?

[fol. 188] The Witness: I know what you are driving at, but I still must adhere to the position that it is the value of the capital and labor employed in the jurisdiction that in my judgment is the proper basis for apportioning the income of an enterprise which operates in many jurisdictions. It is an integrated enterprise and the income itself is an integrated thing and becomes merely a problem which is economic and statistical and accounting in nature, and I do not want to ask you how to allocate—

The Court: We will never finish this case if you keep on repeating and repeating. Both of you are repeating things—you have asked him that question three or four times. It is perfectly clear that all he says that should be used is the amount of property, physical property and labor. The value,—it is the value.

The Witness: Well, in those terms, of course, I accept in those terms, the incurrence of cost.

By Mr. Wixon:

Q. Let's take one more proposition along that line, sir, because I think it is very important we understand this.

In the state of Michigan, General Motors has a plant where it manufactures automobiles and in the production of these automobiles it has inventories of materials, steel, wood if that is used, whatever it may be necessary to have on hand to manufacture the automobile.

[fol. 189] The manufacturing is done there, in Michigan,

but the selling activity takes place not only in Michigan but in many other jurisdictions.

In your concept of property to which state would you assign those automobiles for purposes of inclusion in your two factor formula?

Would you assign them to Michigan or would you assign them to the jurisdiction where ultimately they were taken for sale, or would you not assign them at all?

A. Well, I would assign to each jurisdiction the proportion of the capital and payroll employed in that jurisdiction.

The Court: He did not ask you that. He asked you a specific question which you ought to answer, it seems to me. He wanted to know that when these automobiles leave Michigan and go to the various states in what jurisdiction or state do you assign the value represented by the automobiles?

That is a simple question. He asked you do you do it in Michigan, do you put it in the state in which the automobile goes, or do you put it nowhere, just let it flit around in the air?

That is a simple question and you ought to answer it if you are an expert in economics.

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The Court: He says when the automobiles were sent to the other jurisdiction and sold there, whereunto does [fol. 190] he allocate or assign the property or the locale of the property.

Mr. Wixon: Then there is the other end of it, sir. Do you assign it to Michigan simply because they are manufactured there? I don't want to get into that now. If I get an answer to the one question that will be enough.

The Witness: Well, if the property, the automobiles, are stored in "X" state and shipped then to other states for sale, I would certainly allocate to the state or location of the cars in the warehouses over a period of a year as a proper basis for allocation to that state of a portion of the income.

• • • • • • •

Q. Now, does that not overlook the fact that all the manufacturing of these automobiles took place in the state of

Michigan, that those assets were physically in Michigan until that car was completed and disposed of one way or another, that is to say, gotten out of the state of Michigan?

The Court: The witness says if they are stored a year in the state other than Michigan or the state of manufacture he would assign it to the state other than Michigan.

The Witness: That is right.

The Court: Why, I don't know, but anyhow—

[fol. 191] Mr. Wixon: And I just asked him if that proposition does not overlook the fact that the manufacturing took place in the State of Michigan, the automobile in one stage of completion or another was in Michigan, until finally when it was completed it was sent out of Michigan.

That is what I asked him, sir; does that negate or give no effect to the fact I have just stated to you about the manufacture in Michigan.

* * * * * * *

The Witness: The property involved in the manufacturing of the car in Michigan, including the normal or ordinary amount of cars kept over a period of a year in the Michigan manufacturing plant would constitute, in my judgment, the property, the portion of property allocable to Michigan in allocating the—or one of the two factors—in allocating income to Michigan, and on the other hand, the amount of cars warehoused in State Y during the period of a year normally maintained there, including the value of the warehouse, represent the property properly allocable for the determination of the portion of income taxable in that other state Y.

By Mr. Wixon:

Q. Suppose one of those vehicles was in Michigan for five months and then out of Michigan for six, that is 11, what would you do?

[fol. 192] A. Well, that involves a matter of feasibility and practicability in apportioning the value of the cars between the state in which the car is manufactured and kept for a certain time, or the cars, and the state in which it is

kept, the cars are kept, in preparation for shipping to the states of the customers.

* * * * * * *

Q. Dr. Studenski, you agree as an economist, do you not, sir, that there is a considerable viewpoint that revenue or income is not, in fact, earned until the product has been sold?

A. Yes.

Q. I understand that it is your viewpoint that despite that rationale, which is rather widely accepted, you believe that the fact of earning, the fact of sale, is of relative immateriality in the determination of an apportionment of income for tax purposes?

The Court: He has already testified to that, Mr. Wixon. I think he must have testified three times, but I know he has. He says it has very little effect, if any. Is that correct, sir?

The Witness: I am puzzled that the act of sale, as such, the sale as such, yes, that is not material.

The Court: All right.

Now, he has said that several times.

By Mr. Wixon:

[fol. 193] Q. Now, sir, as an economist, isn't it a fact that the whole process of manufacture and production is designed to the single end that the product so manufactured or produced shall be sold, and as a consequence of that a profit shall be realized?

A. Yes, sir.

The Court: I am not an economist but I think I could answer that question here.

Mr. Wixon: I am sure your Honor could, but your Honor would not be able to put it on the record.

The Court: Well, I would get it on the record some way or other.

Mr. McGratty: Is it not a matter of judicial notice?

The Court: Yes, I will take judicial notice of that.

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The Court: I want to ask one or two questions. Doctor, the Supreme Court has held that a state may constitutionally tax income derived from interstate transactions because it does not affect interstate commerce, but it cannot tax gross receipts from interstate commerce.

That is exactly opposite from your view, isn't it?

One that does not interfere with interstate commerce and the other does. I understand from your testimony [fol. 194] that you think it is economically all right to tax gross income by a state, based upon the sale there, but not the net income in connection with or related to the sale?

The Witness: It is conceivable the taxing of gross income may be applied in such a manner that it will interfere with interstate commerce, and I would consider that to be improper economically, I don't speak about legally.

The Court: All right; you garbled that one pretty well. But what about the one where the Supreme Court says you can tax interstate transactions by the state based upon the sale within the state?

The Witness: My position is that if the tax is applied merely on the basis of a sale taking place, an exchange there between the producer and the customer of a goods for money, without the use by the producer in that state of capital and labor, then that constitutes an interference with interstate commerce.

The Court: All right.

Do you—

The Witness: From an economic point of view.

The Court: I understand. We are not talking about constitutionality.

Let's suppose that you have a house, that cost you ten thousand dollars, and during the year it increases in value [fol. 195] $10,000 so it is worth $20,000; let's suppose that a hurricane comes along and you did not have tornado insurance, and destroys the house. What is your loss from a tax viewpoint?

The Witness: Income tax?

The Court: Yes, income tax.

The Witness: Viewpoint?

The Court: Yes.

The Witness: Whether it would be a state or a federal—

The Court: Either one.

The Witness: (Continuing) —or federal income tax, either way?

Now, a proper income tax should include the value, monetary value of the services rendered by the house. I suppose you are talking about an occupied house, occupied by the owner and not rented.

The Court: That is right, I am talking about a house that costs $10,000, you can put anything you want about the occupants, but it costs $10,000, its value has increased by $10,000 so it is worth $20,000 and it is destroyed?

The Witness: Yes.

The Court: Now, under the recognized practice in income taxation and accounting what would be the loss to the taxpayer where it is destroyed without any insurance?

[fol. 196] The Witness: Well, the loss is $20,000 in this case. I assume that the $10,000 was after depreciation.

Excuse me—

The Court: Let's say it takes no depreciation.

The Witness: All right; it increased in value to $20,000.

The Court: Yes.

I am talking about the recognized practice, among tax people.

Now, you say you have written books on taxation and you consider yourself a tax expert. I am asking you about the practice now, good tax practice, the majority of the practice, what would be the loss sustained by that man?

The Witness: Well, there are treatments of capital gains and losses vary so vastly from state to state—

The Court: Let's take the Federal. What would be the loss?

The Witness: There is a question of what was the original purchase price by the owner.

The Court: $10,000?

The Witness: That was the purchase price.

The Court: $10,000?

[fol. 197] The Witness: Well, now, the taxpayer lost $20,000, and he may be allowed to spread it in accordance with the Federal law—

The Court: Do you mean to tell me that you hold yourself out as a tax expert and say under the Federal income tax practice that he would be allowed to deduct a loss of $20,000?

That he could take the increment of value in a situation of that kind and could take a loss of $20,000?

The Witness: Well, not—I must beg to be excused. First of all, I want to make a statement here that I have not, as a student of public finance, especially addressed myself to the whole subject of capital gains and losses, particularly as, well—

The Court: Take it as casualty, we could not call it capital gains or losses.

The Witness: This is a subject with which I have not been concerning myself and I cannot claim competence in answering that question.

The Court: To what extent do you think that the advertising produces income?

The Witness: It certainly produces income.

The Court: Does it or does it not produce anything?

The Witness: Yes, it does.

The Court: Why does advertising produce income?

[fol. 198] The Witness: By making the product known and stimulating the demand for the product.

The Court: What has advertising to do with sales?

The Witness: It produces sales.

The Court: And that is the reason why you think it produces income?

The Witness: It produces income, yes.

The Court: You said a few minutes ago that advertising produces income. Now I want to know whether your reason is because it produces sales?

The Witness: It produces sales, yes.

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The Witness: I was very much afraid that when I answered the question that sales, as such, do not produce net income that I may have contributed to confusion.

The Court: You need not w ry about that. No one activity produces net income. I have got as much sense about that as you have. Net income is something that results

from everything; there is no sale of one car that produces net income.

In that connection, because I am a little confused by your testimony—let's suppose now that a car is sent into the District of Columbia and is sold for three thousand dollars. Now what do you call that money that is received by the sale of the car?

[fol. 199] The Witness: Gross receipts.

The Court: All right, gross receipts.

Now, let's suppose that it costs in the manufacture of that car $1,000, leaving $2,000. What do you call the $2,000?

The Witness: To the manufacturer?

The Court: I'm asking you, I don't care who it is to. The $2,000, that's the difference between the $1,000 cost of manufacture and what you call the gross receipts, now what do you call that?

The Witness: The $3,000 is obtained by the sale to a dealer.

The Court: I don't care who it's by, let's say to an individual.

The Witness: $2,000 is the profit to the manufacturer if he sells it at $3,000.

The Court: What do you call it?

The Witness: Profit.

The Court: Isn't that gross income?

Let me straighten you out a little bit. Isn't the sale of the car; the amount you receive from the sale of the car either revenue or gross receipts, in taxation I'm talking about.

The Witness: Yes, sir.

The Court: And isn't the difference between the actual [fol. 200] operating cost to manufacture it and the sale called gross income?

And isn't there deducted from that the authorized deduction, and that's called net income, isn't it?

The Witness: That is right.

The Court: Then you didn't—

The Witness: These are interchangeable terms.

The Court: It isn't interchangeable in the field of taxation in respect to manufacture. Gross income is the amount

that they receive after deducting the actual cost of manufacture. Don't you agree with me, that's gross income?

The Witness: Not in my language.

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By Mr. Wixon:

Q. Dr. Studenski, you agree that there are other approaches which can be taken to the ascertainment of the amount of income which should be subjected to taxation by a taxing jurisdiction, other than the one you have expressed?

A. Other approaches than the one which I have made?

Q. Yes, sir.

A. Yes.

Q. You would concede, then, I take it, sir, that the approach that you have to this matter, that is to say prop-
[fol. 201] erty and payroll, is not the only approach which may be used properly in the ascertainment of income subject to tax?

A. In my judgment the approach which I suggest is the proper approach.

Q. Then, I take it from that answer you would say other approaches are necessarily, in your judgment, wrong?

A. That is right.

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The Court: Well, Professor, you are familiar with the formulas used in most of the states, aren't you?

The Witness: In a general way, in most of the states, yes.

The Court: Do you know what it is?

The Witness: In most cases, a three-pronged formula.

The Court: You don't think that is right?

The Witness: I don't.

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[fol. 202] Mr. McGratty: Very well.

For the consideration of the Court I also renew my offer in evidence of petitioner's exhibit 22 for identification, the list of 29 states and state statutes of which I asked your Honor to take judicial notice.

The Court: And which I did.

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The Court: I think I will accept that in evidence in place of a long detailed testimony, that a witness would go on the stand, you could from your position there say, I wish you would take judicial notice of this and that and that. I think for convenience I will receive that in evidence.

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[fol. 203] Washington, D.C.
Thursday, August 24, 1961

The above-entitled matter came on for further hearing at 10:00 a. m.

Before: The Honorable Jo V. Morgan.

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NATHAN A. BAILY was called as a witness by counsel for Respondent and, after having been duly sworn, was examined and testified as follows:

The Court: Please give your name and residence to the reporter, take a seat.

The Witness: Nathan A. Baily, 5516 Graystone Street, Chevy Chase, Maryland.

Direct examination.

By Mr. Wixon:

Q. Dean Baily, what is your present employment?

A. I am Dean of the School of Business Administration of the American University here in Washington.

Q. And how long have you been Dean, sir?

A. Since the school was established in April, 1955.

Q. What is your educational background, Dean?

A. I have a Bachelor of Science in Social Science from [fol. 204] the City College of New York, and a Master's degree and a Doctor's degree from Columbia University.

Q. What was your field?

A. Economics.

Q. Have you ever had occasion to teach economics?

A. I was a member of the Economics Department of the City College from 1941 to 1946; I organized and taught the first economics course at the Fashion Institute of Technology and Design in New York, and I started in the Economics Department of the American University in 1946, we became a separate department of business administration, I believe, in 1949, and I went with the Department of Business Administration.

Q. Have you ever had any occasion to be or to act, rather, as a consultant in your field?

A. Yes, I have been a consultant to a number of business firms, trade associations.

Q. Have you ever had occasion to do any writing?

A. Yes, I have written a number of articles.

Q. Are you a member of any organizations related to the field of economics?

A. The American Economic Association.

Q. How long have you been a member of that association, sir?

A. Oh, I guess I started as a student member somewhere around 1941.

Q. Prior to your engagement at American University have you ever had occasion to be employed as an economist?

A. Yes, I spent two years with the Research Institute of America, and at that time was teaching part time in the [fol. 205] Economics Department of City College and then, of course, was full time in between that period 1941 to 1946.

Q. Are you listed in any publications directed to the field of economics?

A. Yes, sir, I am in the handbook of the American Economic Association, and a variety of Who's Who books.

Q. Now, sir, I would like you to listen to the following statement of facts.

General Motors Corporation, the petitioner in this case, is engaged primarily in the manufacture and sale of automobiles, trucks and other motor vehicles, parts and accessories therefor and engines.

General Motors does not have any plant, does not conduct any manufacturing or assembly operations in the District of Columbia; General Motors does engage in regular

and systemic promotion and selling of its products in the District to customers in the District and in liaison activities with its customers, including the United States of America, through offices located in the District and employees located in the District, and through traveling employees who come from time to time to the District; the activities of General Motors Corporation in respect of the promotion, sale and distribution of its products in the District of Columbia are the same as its methods of promotion, selling and distribution of its products throughout the country.

During the year 1957, General Motors had total sales of [fol. 206] its products amounting to $9,461,855,974; during that year General Motors' sales to customers of General Motors in the District and to whom shipments of products were made within the District amounted to $37,185,704; during the year 1958, General Motors had total sales of its products amounting to $7,853,393,381. During that year General Motors' sales to customers in the District of Columbia and to whom shipments were made within the District, amounted to $32,542,519.

The District of Columbia Income and Franchise Tax Act of 1947, as amended, which act was in effect during the years 1957 and 1958, and which act is applicable to General Motors Corporation, imposed a franchise tax upon General Motors Corporation at the rate of 5 per cent upon its taxable income for the privilege of carrying on or engaging in trade or business within the District and of receiving income from sources within the District.

In the case of a corporation such as General Motors which carries on a trade or business both within and without the District, the act provides that the measure of the franchise tax payable by the corporation shall be that portion of the net income of the corporation as is fairly attributable to any trade or business carried on or engaged in by it within the District and such other net income as is derived from sources within the District.

The statute provides further that if the trade or business of a corporation is carried on or engaged in both within and [fol. 207] without the District as is the case of General Motors, the net income of the corporation shall be deemed

to be income from sources within and without the District, and in such case the portion of the net income subject to franchise tax shall be determined under regulation or regulations as prescribed by the Commissioners.

The total net income of General Motors required to be apportioned for purposes of District franchise tax under the Income and Franchise Tax Act of 1947 was $1,312,092,839 in 1957, and $653,396,893 in 1958.

In each of the years 1957 and 1958 the District of Columbia pursuant to regulation determined the portion of General Motors' total net income attributable to the trade or business carried on by General Motors within the District during those years by multiplying total net income by a fraction, the numerator of which was the dollar amount of sales by General Motors of its products to District customers, which products were shipped to such customers in the District, and the denominator of which was the dollar amount of General Motors' sales of its products to its customers everywhere.

Assuming all of the following facts, Dean Baily, do you have an opinion as to whether the method of apportionment of the net income of General Motors Corporation as used by the District of Columbia resulted in a reasonable approximation of the net income of General Motors which was fairly attributable to the business carried on by General Motors within the District of Columbia during the years 1957 and 1958?

A. I do.

[fol. 208]

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Q. Would you please state your opinion, sir?

A. I think it is a reasonable approximation.

Q. And what, sir, is the basis for your conclusion?

A. Well, possibly the simplest and quickest way to answer—at least to begin the answer to that is, what Red Motley, the past president of the U.S. Chamber of Commerce and a very successful businessman has always said, that nothing happens in business until a sale is made. The purpose of a business is to produce sales at a profit. You have a measurement of sales here, the District of Columbia

is primarily a marketing area. If I remember the last figures of Sales Management magazine, it is the 9th most important trading area in the country. Its value to a business is its value as a trading area, so I think that using the sales data provide a reasonable approximation.

Q In your use, Dean Baily, of the word "income," do you have any particular definition which you have employed in your answer?

A. I would use the usually accepted business definition that is income before taxes of the amount of money that comes in minus the amount of money that is spent and the difference, if it is in the black, represents income.

The Court: Income or net income?

The Witness: It is a net figure, your Honor, yes.

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[fol. 209] Q. Dean Baily, as a matter of pure economic theory, would the use of a formula based upon property and payroll produce a more reasonable approximation of the net income of General Motors fairly attributable to its trade or business within the District than the use of sales alone, in your view?

A. I don't think so, because sales, the sales figure includes the expenses of production; it includes, then, the contribution of labor and capital to the production of goods.

The only way a company can make income is either by sales or investments; if it makes it through sales it vests in the costs the factors of production to be able to have the goods to sell.

Therefore, the selling price, if the company is in business successfully in making a profit, the selling price provides a return for the expenses as well as the profit.

Q. Dean Baily, would the use of a property factor alone produce a proper result, in your opinion?

A. Are you talking about the District of Columbia or in general?

Q. The District of Columbia.

A. No, because the sales, I think, is the broadest factor which takes into account all of the other factors whereas property would leave out some vital factors.

Q. And in your view would the use of payrolls alone produce a reasonable result?

A. No, for the same reason, that payrolls is only part of the picture.

[fol. 210] Q. Dean Baily, as a matter of economics do you have an opinion as to whether income is produced alone by property and payrolls?

A. Yes, I think the answer is clearly that—if I am allowed to refer to your fine illustration of the ore-boat—the Judge made very clear that just adding capital and labor together gives you no income. Income arises out of a sale and without a sale you can't have income.

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Mr. McGratty: If your Honor please, I understand that the District proposes to call a total of three expert witnesses. I would ask the privilege of reserving the right to cross-examine each of the witnesses until the completion of the direct testimony of each of the three expert witnesses.

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The Court: I understand that. I think you ought to finish one witness up at a time. I really do. But I want to ask a question before you cross-examine.

I want you to bear in mind what apparently has been overlooked, not in this question because it was included in the question, but generally in these cases, that the law is not an income tax law, it is a privilege tax and it is measured by income. We do not have an income tax law like we did in the Kodak case and we do not have in the Kodak case the provision that I am going to call your attention to and I want you to keep in mind.

[fol. 211] It says that the tax is to be measured, as you know, by—all privilege taxes provided that—by the net income that is fairly attributable to the District of Columbia, and it provides that if the business is carried on, now, not the total business of the taxpayer, but the business that we are concerned with, here we are concerned with the segment of activities of General Motors which involves manufacturing in one place, sale in another.

Will you bear that in mind?

The Witness: Yes, sir.

The Court: Now the Act says that if the business is carried on within and without the District, the net income must be apportioned that way, it must be deemed to be from both sources.

Now, let's suppose that a corporation manufactures all of its property, all of its products in Baltimore City, and sells them all in the District of Columbia.

Bearing in mind that the Act says that it must be deemed to be net income both from within and without the District, what formula would you use for a situation like that?

Mr. Wixon: If your Honor please, may I suggest one modification, that its total income must be deemed to be from within and without the District. All of its income together, sir.

[fol. 212] The Court: The law does not say that, the law says if the business is carried on within and without the District, and it does not say anything about total business, it says the business, the net income therefrom must be apportioned within and without the District.

Now, here is a corporation where the goods are manufactured in Baltimore and sold in the District.

Now, do you agree or don't you agree with me that if sales is the only factor that is to be used that you could not comply with the law?

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The Witness: In terms of the District of Columbia, I think that if—

The Court: I am not asking you about terms of the District of Columbia, I am asking you if you use sales as the only factor; in other words, you are going to assign to the District of Columbia 100 per cent of the net income from that business, how can you justify that?

The Witness: If Maryland and the District both used sales as the basis for their apportionment then I think that would be perfectly proper for the taxpayer.

The Court: But there were no sales in Maryland at all?

The Witness: Then Maryland would get no tax if sales were used as the basis.

The Court: Therefore, under this law, it would not be deemed to be net income from both Maryland and the Dis-

[fol. 213] trict. How could you comply with the law if you taxed 100 per cent, the District of Columbia had 100 per cent of the net income taxable in the District?

Would that be deemed to be an income from sources within and without the District?

The Witness: I think you are getting me into a legal question here with the sources where I can give you a layman's opinion if you want it.

The Court: Can't you answer this question, that if—forget all about the law—let's forget the law.

The Witness: All right.

The Court: If a company is engaged in business in Baltimore, in the manufacturing business, and engaged in business in the District in the sale of goods, that is this business involves both within and without the District, and 100 per cent of the income is assigned to the District, does that mean that the income is deemed to be from both within and without the District?

Now, forget about law, I am asking you a simple question.

The Witness: It is not a simple question.

If you take the approach that the sales includes the total end result—

The Court: No,—

The Witness: (continuing) —then the answer to your question is Yes.

The Court: I am asking you about fact. Is the income [fol. 214] deemed to be from both within and without the District if you assign 100 per cent to the District?

The Witness: But there is no income without the District if you said that there is 100 per cent of sales in the District.

The Court: That is right; and doesn't that violate the provision that it must be deemed to be income from within and without the District?

The Witness: Is this the legal or the economic question now?

The Court: Let's call it the economic question.

The Witness: Could you restate that for me, please, Judge?

The Court: Let's say that I want to hold economically,

that income from a business carried on within and without the District must be deemed to be income from within and without the District; would you say that that could be possible if 100 per cent of the income is assigned or allocated or apportioned to the District?

The Witness: On an income basis, yes.

The Court: How could it be?

The Witness: Because all of your sources of income were coming from within the District and your hypothesis where you say 100 per cent of sales are in the District.

The Court: That is only because you are using a sales factor?

The Witness: That is right.

The Court: Yes, but isn't that the viciousness of the factor?

[fol. 215] It does not comply with what I want to do?

The Witness: But if all fifty jurisdictions used the same factor regardless of what the factor would be, then from the viewpoint of the taxpayer it would make no difference.

The Court: That would be true if all of them used the uniform state law factor?

The Witness: Or if they used a 12 point factor.

The Court: That is exactly, if all used the same factor, of course, you are correct.

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Cross examination.

By Mr. McGratty:

Q. Dean Baily, have you published any books on the subject of economics?

A. No, I have published no books.

Q. Have you published any articles on the subject of economics within the last ten years?

A. Yes, a variety of them.

Q. Would you mention the names of some of those articles and tell us in which periodicals they appeared?

A. Well, I think the most recent were on the clash of economic philosophies and the forecast of economic condi-

tions which were articles based on speeches at the Linen Supply Association convention and published by the trade publication in the field; I do a monthly column for Modern Securities Services, which is a publication for the mutual [fol. 216] fund industry on economic conditions as they affect the mutual funds industry and the general economy; I also do a monthly book review on a subject in finance, investment, management, economics for that same publication; oh, until about a year ago when I just did not have time to keep up with it, every three months was a forecast of economic conditions as it affected the building industry for the Suburban Maryland Builders Association; there have been a variety of book reviews; there was an article in 1958 in Nation's Business—that was really on management though, on criticism of employees rather than economic conditions; there have been some articles on the agricultural situation, the agricultural price situation, the mining subsidy question.

Q. Is that about all?

A. Yes, this was something I did not bring a list along.

Q. You don't recall any others at the moment?

A. If you want to give me a few minutes I could probably think of a few more.

Q. Dean Baily, let us assume that a manufacturing corporation is engaged in business in only one state, it does all its engineering, all of its manufacturing, all of its administrative work and all of its selling in that one state; now, let's assume that the total cost to the manufacturer is $4 million, and let's assume that 25 per cent of the total cost is incurred by the engineering department, that 25 per cent is incurred by the manufacturing department, that [fol. 217] 25 per cent is incurred as administrative expense, and 25 per cent is selling expense.

Let's assume that the total net income of the corporation is 100,000 dollars.

Now, what per cent of the total net income would you ascribe to the activities of the engineering department? What per cent would you ascribe to the activities of the manufacturing department; what per cent to the selling department; and what per cent to administration?

A. I would not ascribe any percentage of the income, and I do not know of any case where that is either done or for what purpose.

You would certainly want to know what percentage of costs, of your total cost picture come from each part of your operation, but this would be getting into the arguments that filled the economic theory of the 19th century particularly in trying to determine what is value.

You could not have the product without all of these components but what percentage of income if let's say, your engineers came up with something, a little feature on a car that happened to make it the most salable feature and therefore you took ten per cent extra share of the market, and that cost a dollar, would you say that that was responsible for that income?

Q. Now, Dean Baily—

A. I just don't follow why you want to ascribe income to—

Q. Let me ask you this: would you say that a portion of [fol. 218] the net income of the corporation is attributable to the activities of the engineering department?

A. Well, if we want to choose words precisely I would not use the term attributable. I would say that without the activities of the engineering department you could have no product, and if you had no product you would have nothing to sell, and if you had nothing to sell you would have no income.

Q. Would you say that a portion of the net income of the corporation resulted from the activities of the Engineering Department?

A. No; I would say that the income has to result either from sales or investments.

Q. Let me take it one by one. Do I understand you to say that in your opinion no portion of the net income of that corporation is attributable to the engineering activities?

A. No, you put words into my mouth that I was not saying.

The Court: You just say No, if you don't agree with him.

The Witness: No; that would not be an accurate phrasing of my opinion.

The Court: He did not ask you anything except whether or not you would say that a portion of that income was attributable to engineering.

Now, if you say No, all right; let it go at that.

A. Right.

Mr. Wixon: If your Honor please, he says it is a little bit impossible to answer on a No basis.

The Court: There is where our trouble comes, instead [fol. 219] of answering the question categorically, he is on cross-examination, he puts something in that makes it complicated. All you want to know is whether it would be attributable to it?

Mr. McGratty: My question is this: In your opinion, is any portion of the net income of that corporation attributable to the activities of the engineering department?

A. As long as you use the word "attributable," no.

By Mr. McGratty:

Q. Can you answer that Yes or No?

A. Then you get a straight No.

Q. In your opinion is any portion of the net income of that corporation caused by the activities of the Engineering Department?

A. If you want a Yes and No answer because of the fact that economic questions are rather complicated, if you do not allow either a change of phraseology or a qualification, the answer there, too, has to be No.

Q. In your opinion, does any portion of the net income of that corporation result from the activities of the Engineering Department?

Mr. Wixon: If your Honor please, may I ask the purpose of using the word "result" or "caused by"?

The Court: Because the witness is getting into semantics. He says he cannot answer according to his question, now he is trying to put it every sort of way he possibly can think of. I am going to think of two or three ways myself and ask him.

[fol. 220] Mr. Wixon: If your Honor please, you can't make a direct response.

The Court: You are objecting to the question not the response.

I think he must answer it.

Mr. McGratty: Is the answer No, Dean Baily?

The Witness: Without any qualification, it would still have to be No because it is incomplete as you phrase it.

By Mr. McGratty:

Q. In your opinion, is any portion of the net income of the corporation due to the activities of the engineering department?

A. Again, without a qualification I must say, No.

Q. In your opinion is any portion of the net income of the corporation attributable to the activities of the Manufacturing Department?

A. If you won't let me qualify it, still it is No.

The Court: If it is not attributable, you know what that means, if it is not attributable, it is not attributable.

By Mr. McGratty:

Q. In your opinion, is any portion of the net income of the corporation caused by or due to the activities of the manufacturing department?

A. No.

Q. In your opinion, does any portion of the net income of the corporation result from the activities of the manufacturing department?

[fol. 221] A. Isn't that the same question that I answered before?

Q. No, I am speaking of the manufacturing department now.

A. No, for the same reason, we are quibbling over a key word there.

Q. Well, in your opinion is any portion of the net income of that corporation attributable to the activities of the sales department?

A. I would still like to qualify this, but I think here I

can say, Yes, because the weight of evidence is in this direction, Yes.

Q. What weight of evidence are you referring to?

I have not referred to any weight of evidence in my question.

A. Selling activities, by those two words, the weight of evidence is contained there.

Q. What evidence are you referring to, Dean Baily?

A. The fact that you can't have any income until you have a sale, and if you have selling activities and they are successful that is what creates your income.

Q. So, if I correctly understand you now, in your opinion some part of the net income of that corporation is attributable to the activities of the sales department; is that correct?

A. To those activities which result in sales, which are successful.

Q. Now, in your opinion, is any part of the net income of that corporation attributable to the activities of administration or the administrative department?

A. You have a situation in many companies where—

[fol. 222] Q. Can you answer that question Yes or No, Dean Baily?

Mr. Wixon: If your Honor please, he is trying to answer it.

The Court: We are talking about one company. You are just asking about General Motors, aren't you?

Mr. McGratty: I am speaking about a hypothetical company, your Honor.

The Witness: Your Honor, I find myself in this problem and I would like you to advise me what to do. That is, if you are trying to make a generalization, the old story that for every generalization there is an exception. In the case of the last question, in many corporations people whose salaries are listed as administrative expenses frequently are employed in selling, frequently on a large contract, a key official who does not have a sales title and is not classified in the sales department will play a major role in securing the business for the company.

Now, if the counsel is asking me for a completely airtight, hundred per cent generalization, I don't know how to make that kind of a generalization in the affirmative when I know of situations like this which violate it.

The Court: You mean all those in administrative departments that have to do with selling—

The Witness: No, I am saying that in many cases on a key aspect of business for a company the president himself, sometimes the Chairman of the Board—

[fol. 223] The Court: Wouldn't you say that the president has something to do with selling?

The Witness: If he has, then it fits in that picture.

The Court: How can he be president unless he is president of everything?

The Witness: In some cases the president's primary concern is the overall rather than the selling. There is a vice president for sales, a vice president for marketing, and a sales manager.

My problem with the counsel's questions, if they are to be answered blanket Yes or No, there are many exceptions to the flat statement, and, therefore, it makes it an inaccurate statement to say it is a hundred per cent true or false.

The Court: You concede under certain conditions when the persons in administration have to do with sales that they would have—

The Witness: If they went out and made possible the sale then income would be created by the sale.

If they picked up a phone and called a friend in a customer's company—

The Court: Let's take a man who is vice president of a corporation, most of them in charge of sales. He does not have to pick up the phone to direct the sales.

The Witness: No.

[fol. 224] The Court: Would you say that his activities contributed to the income?

The Witness: Oh, yes; but he would be vice president of sales and in the selling activity of the earlier question. This question now is administrative activities.

The Court: Well, he is administrative?

The Witness: Well, the sales manager is an administrator and the district sales manager is an administrator, too, it is question of the balance.

The Court: All right.

By Mr. McGratty:

Q. Do I correctly understand you to say in substance, Dean Baily, that in your opinion the activities of the administrative department of the corporation do contribute in some measure to the net income of the corporation to the extent that administrative offices assist the selling effort?

Would that be a correct statement of your—

A. No, to the extent that the administrative officers make possible the actual sales.

Q. Well, now,—

The Court: You have the answer?

Mr. McGratty: Yes, I have, sir.

[fol. 225] By Mr. McGratty:

Q. In your opinion, do all of the activities of the administrative officers lead ultimately to the making of sales by the corporation?

A. They should.

Q. So, therefore, would you say that if all of the administrative activities of the corporation lead ultimately to sales—

A. I said should lead ultimately.

Q. If they do lead ultimately to sales, in your opinion a portion of the net income of the corporation is attributable to the activities of the administrative department; is that correct?

A. No, we are right back to where we started and is it permissible, your Honor, for me to just make a statement because I think we can save a lot of time.

The Court: You can do it on redirect, if you don't agree with him.

The Witness: No, because of the phraseology he has introduced, as attributable is where we are coming to difficulties.

The Court: Don't let's go through all that other again.

The Witness: I think we can clarify the thinking if I may.

By Mr. McGratty:

Q. Let me just ask you a few more questions along this line, sir.

Do I correctly understand that it is your opinion that a portion of the net income of the corporation is attributable [fol. 226] to the activities of the sales department?

A. No, you have changed it just slightly from what I said before.

The Court: I thought you said it was?

The Witness: I said that results in sales. It is the sales that create the net income.

The Court: You mean if a sale is abortive you would not apply it?

The Witness: There is no income if you don't make the sale.

The Court: I am just asking you.

The Witness: Yes, sir.

By Mr. McGratty:

Q. Let us assume that the corporation does sell all of the products which it manufactures.

Under those circumstances, in your opinion, is a portion of the net income of the corporation attributable to the activities of the sales department?

A. No, because of the same language we have been hassling about, and if your question was phrased as you started to then I think we might have had agreement.

It is the sales that create the income; the income is possible only if there are sales; to sell you have to have a product or a service; if you are a manufacturer you have a product; you cannot have a product without all the things that go into it; so if you had changed in all of your ques-

[fol. 227] tions from attributable to "made possible by" we would have been in agreement.

So, a product is made by putting together the raw materials and processing that. There are a lot of people that come in; your purchasing people, your transportation people as well as your manufacturing people and your administration, but there is no income until the product is sold.

It is only the sale that creates the income.

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By Mr. McGratty:

Q. Do I correctly understand your testimony to be that in your opinion the net income of a corporation is made possible by all of those factors without which it would be impossible to sell the product of the corporation?

A. The product is made possible by the activity of all those factors. The income is made possible only by the actual sale. You have no income if you cannot sell.

Income is created only in cash or in an account receivable, or in another form of credit by the act of selling.

Q. Now let's see if I understand that.

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Is it your opinion that the product results from all of the activities which contribute to the making of the product—

A. I think that is almost a circle there, yes.

[fol. 228] Q. And that the income is attributable to the sale of the product?

A. The income is created from the sale of the product. You are not attributing anything, you are creating it by the act of selling, by the process of selling.

That is where income comes from, other than investments.

Q. Is it your opinion that the income results only from the sale of the product?

A. You cannot have income without a sale, if we disregard for the time being the investment factor in a corporation's activities.

Q. What percentage of the net income of the corporation that I have assumed in the hypothetical example, is attributable to the activities of the sales department?

The Court: Wait a moment. He has just said a few minutes ago, and I think—he says there is no part of the net income attributable to sales. He does not like the word attributable.

The Witness: Yes, your Honor.

The Court: He says that income results from a sale. Is that correct?

The Witness: Yes, sir.

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By Mr. McGratty:

Q. Dean Baily, let us assume that all the products of [fol. 229] a given company are manufactured solely in Michigan and that the total costs incurred in Michigan in the manufacture of the product is a million dollars, and let us assume that all of these products are sold by the corporation in the District of Columbia area by salesmen located within the District, the salesmen enter the contracts, receive the payments, and deliver the products within the District.

Let us assume that the total cost of those sales activities carried on in the District of Columbia is $10,000; let us assume that the total net income of the corporation is $100,000.

In your opinion, what portion of the net income of the corporation is attributable to the activities which it carries on within the District of Columbia?

Mr. Wixon: May I interpose an objection?

Dean Baily has said on a number of occasions that the use of the word "attributable" is one that he does not—

The Court: He says the word "attributable" under the facts as asked by the counsel, but he may believe now that attributable is the proper word. He did it on your question, it had attributable in it, and that may be a proper word now.

The Witness: May I respond to that, your Honor?

The Court: Yes.

[fol. 230] The Witness: This is very reminiscent of the discussions in economic theory about which factor of production is responsible for value and I think the best answer is, one that has been used traditionally, in a three-legged stool, which leg is the most important leg to the stool?

If you pull any one of them away, how are you going to then get into the argument as to which is—

The Court: He asked you a different question about a situation where the manufacturing was all in Michigan and all of the sales activities take place in the District, every sale activity.

Now, what portion of the net income would be attributable to the District of Columbia, if you can use the word "attributable"?

The Witness: In terms of the sales—this is the same question you asked me except the locale is shifted from Baltimore to Michigan, and my answer is still the same.

The Court: My question was whether or not that would comply with the law which requires that the income has to be assigned to both within and without the District. This is an entirely different question. He just asked you that simple question.

The Witness: Would you repeat the question, then?

Mr. McGratty: Would you like me to repeat the entire question?

The Witness: Yes, would you?

Mr. McGratty: I will be glad to do so.

[fol. 231] By Mr. McGratty:

Q. Let us assume that all activities of every nature and description of a business manufacturing corporation are performed in the State of Michigan with the sole exception of its selling activities. Assume that all of its selling activities are conducted solely in the District of Columbia and the entire product of the manufacturer is sold in the District of Columbia by salesmen located there who execute the contracts there, receive payment there, and deliver the product there.

Let us assume that the costs incurred by the manufacturer in Michigan are one million dollars and let us assume that

the costs incurred by the manufacturer in the District of Columbia are $10,000 and that the total net income of the manufacturer is $100,000.

In your opinion what portion of the net income of the manufacturer is attributable to the activities carried on by the manufacturer in the District of Columbia?

A. Again, we will have that argument about language; if I can answer your question by saying, all of the net income of the corporation results from the sales in the District of Columbia.

Q. And in your opinion does none of the net—

The Court: If he says all, there is nothing left.

By Mr. McGratty:

Q. So, do I understand your answer as qualified to be that in your opinion all of the net income results solely from the activities carried on in the District?

[fol. 232] A. Was created by the sales in the District of Columbia I think was my precise language.

The Court: He used "created" now.

By Mr. McGratty:

Q. All right; I understand that to be your qualified answer.

Let me ask you this question: In your opinion did all of the net income earned by the manufacturer result from the activities—I want to find out whether he distinguishes between results.

The Court: He does distinguish between result and created by.

The Witness: That was my answer.

By Mr. McGratty:

Q. Do I understand that you do not assert that all of the income results from the activities carried on in the District?

A. All I have said is that all of the income was created by the sales in the District of Columbia.

The Court: But he is now asking you a question, whether or not apart from the created now, whether or not your opinion is whether or not all of the income resulted.

Now, if you say no, if you do not like that word, you just say No.

The Witness: We are getting into that semantic argument you referred to before.

The Court: Yes. Well, he asked you whether it resulted. [fol. 233] Now, if you don't think it resulted why just say so.

The Witness: It resulted in the sense of being created in the District of Columbia because income comes from sales and that is where the sales were.

By Mr. McGratty:

Q. In your opinion, did any of the activities carried on by the manufacturer in Michigan contribute in any way to the net income of the corporation?

A. They made possible the product which was sold which created the income.

Q. Can you answer my question as I asked it?

Mr. Wixon: If your Honor please, he is attempting to answer it.

This is argument now with the witness.

The Court: No, I don't think it is argument. He asked the witness a question and the witness qualifies it every time he answers it. I think you could say No, and then qualify it.

The Witness: All right; if that would be the proper procedure.

Then, following the Judge's suggestion, the answer would be No, the activities which took place in the State of Michigan made possible the product which was sold and the action of the sale in the District of Columbia was the creation of the income.

By Mr. McGratty:

Q. That is, if I understand you correctly, the activities [fol. 234] conducted in Michigan made possible the sale—

A. Made possible the product.

Q. Made possible the product which was sold in the District of Columbia but did not contribute in any way to the income of the corporation?

A. We are getting into that same semantic argument again, which of the three legs on the stool contributes to the stability of the stool.

Q. Well, do I understand you to imply that both the activities conducted in the State of Michigan and the activities conducted in the District of Columbia contributed to the income of the corporation?

A. No, the only income in this situation you have posed to me is the income that arises out of the sale.

The sale in your hypothesis took place in the District of Columbia. It would not have mattered what the cost of the manufacturing activities was, where they were located, how much processing took place, whether the corporation owned its own coal mines or bought coal from somebody else, and everything else in the production process, there would be no income unless there were a sale.

Q. So, you distinguish between make possible and contribute; is that the distinction that you make, Dean Baily?

A. No, if we want to get into the terminology of economics I would distinguish between what might be termed the factors of production and the creation of income. The income is created by the act of the sale; you have to have something to sell.

[fol. 235] Now, it may be we could have hypothetical illustrations of having something to sell which cost you nothing, they were a gift to you and therefore you could have income without having any processing or any cost of activities.

Q. What are the factors of production to which you just referred?

Are there certain basic factors of production recognized by economists?

A. Well, I don't know how well recognized, sir, they are today, but at one time it used to be considered that labor was the primary factor of production, along with land.

Q. And is capital considered a productive factor?

A. In the derivative sense, in Ricardo's economic theory capital was congealed labor and then that becomes the third factor but in a sense derived from the labor factor.

Q. Well, in your opinion, what are the basic productive factors?

A. Land, labor, capital, the entrepreneur, and government.

Q. Land, labor, capital—

A. The entrepreneur and government.

The Court: And the administration?

The Witness: Would be the entrepreneur.

By Mr. McGratty:

Q. Do all of these factors, in your opinion or does the use of all of these factors in your opinion contribute to the net income of the corporation?

[fol. 236] The Court: He has answered that at least ten times and he says this, that it contributes to the manufacture of the article but it doesn't contribute to the income.

Now, that's what he said. He has said it time and time again. You can draw your own conclusions.

By Mr. McGratty:

Q. Let me turn to a second case. Let us assume the facts to be exactly the same as those discussed in the case I last gave you except that the salesmen or representatives of the corporation in the District of Columbia do not accept any orders for the product and that all orders for the product are sent by the District of Columbia purchasers or residents to the State of Michigan where they are accepted or rejected, and assume that if accepted payment is made to the corporation in the State of Michigan and shipment is made to the purchaser, f.o.b. Detroit,

Under those circumstances, in your opinion, what portion of the net income of the corporation is attributable to the activities carried on within the District?

Mr. Wixon: If Your Honor please, may I interpose at this time an objection? We are far beyond the scope of

the direct examination, we are far beyond the factual situation posed to this witness.

The Court: Mr. Wixon, one way to test a theory is what we used to call the acid test, where you take the extreme, [fol. 237] so I think that is probably what counsel is doing.

Mr. McGratty: Yes, your Honor.

The Witness: Also known as the reductio ad absurdum.

The Court: Quite so.

The Witness: I think you are asking me a question as a non-lawyer, I can give you a layman's opinion. You are asking me to define the legal point of sale.

Mr. McGratty: No, I'm asking you to assume that the sale takes place in Michigan and that the only activities which are carried on in the District of Columbia are the soliciting activities of the salesmen stationed in the District of Columbia.

A. But I respectfully submit that what you are asking for is what is the legal point of sale.

By Mr. McGratty:

Q. No, I'm asking you, Dr. Baily, in your opinion, in your opinion as an economist, what portion of the net income of the corporation is attributable to the soliciting activities carried on by the manufacturer in the District of Columbia?

A. I still submit that that's a question of law here—I have expressed my basic position that income arises out of sale.

Now, there are many ways, as we know from various stages in history, not too long ago, O.P.A., O.P.S., W.P.B., and so on, where certain devices are used to change the legal point of sale.

Now, I'm no expert on that.

[fol. 238] The Court: You can answer it from the activity standpoint.

The Witness: But the counsel has a very important point that makes it—

The Court: Let's forget about where the sale takes place. Let's say as he asked you where the order was sent to

Michigan, it was there processed and accepted, the money was received in Michigan—

The Witness: But perhaps you can help me, sir. My problem is are we talking now the sale as a functional thing or are we talking about the sale as a legal thing in terms of where the documents are signed?

The Court: I think he is talking about activities?

Mr. McGratty: I am talking about activities and I am asking whether you have an opinion as an economist as to what portion of the corporation's net income as a matter of economic theory is attributable to the activities which the corporation carries on in the District of Columbia.

The Witness: If, from the functional viewpoint the sale is completed in the District of Columbia, regardless of where the documents are signed or the checks are mailed, then the income arises where the sale is made.

[fol. 239] By Mr. McGratty:

Q. Now, I have asked you to assume that the sale takes place and is completed in the State of Michigan.

A. But you are proposing something which is inconsistent with both business practice and impossible because if the selling activity takes place in the District of Columbia and you and I shake hands and say, Now, send me 20 cars, but send the check to the State of Michigan, then we have a functional activity and a legal activity.

Q. Now, Dean Baily, I point out to you that there was not included in my question any of the assumptions which you have just made.

Now, perhaps you don't have clearly in mind the question which I asked you?

A. Perhaps if you repeat it I will try again.

Q. I asked you to assume that in the District of Columbia the manufacturer solicits by salesmen residents of the District, and I asked you to assume that as a result of that solicitation and prompted by it, the residents of the District of Columbia even go to the State of Michigan and there purchase the automobiles of the manufacturer, so I'm

asking you to assume that the purchase is made and the sale takes place in the State of Michigan.

Under those circumstances, in your opinion, what portion of the net income of the corporation is attributable to the soliciting activities carried on in the District?

A. To be certain that you don't accuse me of making assumptions that aren't there, even though I think you [fol. 240] spelled out my assumptions very effectively, may I ask for a bit of further information?

Do the salesmen in the District of Columbia receive the commission on the sale?

The Court: What difference does it make?

The Witness: Because that answers the question, your Honor. If this is merely a formality of going to the State of Michigan—

The Court: But he doesn't—

The Witness: Pardon, your Honor.

But if the sale is done in the District of Columbia and the salesman soliciting there, even though he doesn't accept the check or delivers the merchandise gets the commission from the corporation, it is a sign that the corporation by its own action recognizes where the real sale is taking place.

The Court: Not necessarily.

The Witness: They are not going to pay a salesman a commission if he isn't selling a product.

Mr. Wixon: Your Honor, aren't we into a—

The Court: All right. He has asked a question, answer the question.

Mr. McGratty: May I ask this. Is it impossible for you, Dean Baily, to answer that question which I have put to you unless you know whether the salesman or the solicitor in the District of Columbia receives a commission on the [fol. 241] car?

Mr. Wixon: If your Honor please, the witness has responded over and over that in his view income is the result of the sale. If we want to go out here into semantics as we seem to be getting into and break this thing up into bits and pieces, then I submit to your Honor that it is not subject to any other answer than has been given.

The Court: If that is an objection to the question it is overruled.

You have asked a question and I think the witness can answer it.

What the question is now, you are unable to answer that question unless you know—

The Witness: I need the additional information as to where the corporation in terms of its own practices and recognition pays a commission. Does it pay the commission in Michigan to the man who delivers the car to the D. C. purchaser, or to the solicitor in the District of Columbia who creates the sale.

The Court: All right, now, that is your answer.

By Mr. McGratty:

Q. I'm going to ask you to assume that the salesmen or the solicitors in the District of Columbia are on a fixed annual salary and not on a commission basis.

A. Then I think that in view of everything you have given me that from a functional viewpoint regardless of the law, the sale has arisen in the District of Columbia, the income is created in the District of Columbia.

[fol. 242]

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Q. Now, let me ask you to assume a slightly different case.

Let us assume that all of the activities of the corporation are carried on in the State of Michigan with the single exception of local newspaper advertising in the District of Columbia. Let us assume that as a result of that advertising District of Columbia residents go to Michigan and purchase all of the product of the manufacturer.

Under those circumstances, in your opinion, what portion of the net income of the corporation is attributable to the advertising in the District of Columbia?

• • • • • • •

The Witness: I think that you have carried this reductio ad absurdum or the acid test very effectively to this question where we are now split. There is a sales activity in the District of Columbia through the advertising which

leads to the conclusion to buy the car but that the actual process of purchase takes place in the State of Michigan, and without again being a lawyer, my offhand opinion would be the answer to your question undoubtedly would be something between Michigan and the District of Columbia to decide the relative importance of these two factors of making a sale and some sort of an agreement between them as to how they would divide up the sale which was caused and took place psychologically in the District of Columbia, but where the formalities of the transaction were completed in the State of Michigan.

[fol. 243] By Mr. McGratty:

Q. Let us take one final case. Let us assume that all activities of the manufacturer are conducted exclusively in the State of Michigan and that a group of District of Columbia residents hearing from their friends of the availability of the product of the manufacturer go to Michigan and buy the entire product in Michigan. In your opinion what portion of the net income of the corporation is attributable to the District of Columbia.

A. Do they hear from their friends in the District of Columbia or their friends in Michigan or their friends in Maryland?

Q. From visiting relatives.

A. Visiting them in the District of Columbia?

Q. Yes.

A. Then again I think you have a split, a sharing between the District of Columbia and Michigan with obviously the District of Columbia's share in here being somewhat reduced as compared to the actual advertising in the District of Columbia by the corporation.

Q. So, under those circumstances, if I understand you correctly, a portion of the net income is attributable to Michigan, and another portion is attributable to the District of Columbia?

A. Because the sale took place in the State of Michigan, although part of the sale, trying to break down the process

in this hypothetical manner that you have given, took place in the District of Columbia as well.

[fol. 244] By Mr. McGratty:

Q. In your opinion as an economist does any portion of the net income of a corporation arise from the use of capital?

A. All of the net income of a corporation comes from sales or investments as we have spelled out before. To have either sales or investments generally you need some capital, but that does not arise from—the income arises from the sales. It is created by the sales.

Q. So, no portion of net income arises from capital?

A. Not in those words arises from.

Q. And in your opinion as an economist, does any portion of net income arise from labor?

A. I think I have answersed the question when I said that all of income arises from sales or investments.

Q. And none, therefore, from capital—

A. As the Judge pointed out, all covers a hundred per cent.

Q. Let me read to you a sentence from a government publication, "National Income, 1954 Edition," published by the United States Department of Commerce, Office of Business Economics. Are you familiar with that publication?

A. I have a slight familiarity with the National Income figures.

Q. Only slight?

A. Slight.

Q. Reading from the first page of this publication I quote:

[fol. 245] "Total output is also measured, in terms of the factor costs of producing it, by the national income—the aggregate earnings of labor and property which arise from current production."

Do you disagree with that statement?

The Witness: Those who know much more about income figures than I will tell you this a very difficult and con-

troversial area of what is known as accounting in terms of the total economy, not for a particular corporation, not for a particular individual or a particular business firm. This is for the entire economy.

As a matter of fact, it is what Senator Goldwater frequently describes as the national lie rather than the national income, because as best I understand it these figures are based on expenditures.

So, for example, if government expenditures go up then the national income of the United States goes up.

For example, the work of your wife in the house, if she does not hire a maid and does not pay the maid for that work is not included in national income. If she hires a maid and the maid does exactly what she did but you pay her, that, then, goes into national income, because national income really, as best I understand it, is expenditures, and I think it is completely irrelevant to what we have been discussing today.

[fol. 246] The Court: Is that your answer?

The Witness: Yes.

• • • • • • •

Q. I will put the question this way; do you agree that the aggregate earnings of labor and property arise from current production?

A. They are measured by the expenditures, in other words, the figures that are given—

The Court: He merely asked you "arise." He didn't ask you were they measured by. He asked you a simple question, do you agree—

The Witness: I happen to be one of the critics of the national income concept and think there are many weaknesses, so I couldn't list myself as in agreement, if we are using your one statement to refer to the whole pattern of national income figures of the Department of Commerce.

So I would have to say that I think there are many weaknesses and as a generalization in terms of your asking me the over-all question I would say that I do not agree that the national income figures are the most effective measurement of our national economy, and I feel they have no relevance to what we are talking.

The Court: He didn't ask you that. He asked you whether national income arises from production.

The Witness: Your Honor, the purpose of production [fol. 247] for any economy is consumption—the answer is no, then.

The Court: You disagree?

The Witness: All right.

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Redirect examination.

By Mr. Wixon:

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Q. You had responded No to the totality of the question, I believe, explaining that your thinking did not coincide necessarily with the statement here.

Could you elucidate upon that a bit, sir?

A. Yes, since I had to make a choice between a yes and a no, and since only a very small portion was quoted since it was incomplete and I think somewhat out of context, and since I felt it needed many qualifications to be given any reasonable answer, but the choice was Yes or No, therefore, I felt the weight was towards the No.

Mr. Wixon: I have no further questions, your Honor.

The Court: Let me ask you this.

If I understand your testimony, it is that sales produce the income?

A. Yes, your Honor.

The Court: And that manufacturing, engineering, property, everything else, labor, produces the article?

[fol. 248] The Witness: Yes.

The Court: Now, you could not have a sale without the article, could you?

The Witness: No, your Honor.

The Court: Well, now, how do you explain that these things do not produce the income if the activities other than sales produce the articles sold and the articles sold produces the income, why does not a chain show you that these others do produce income, too, don't they?

The Witness: Your Honor, we are again getting into the words.

No. 1, your Honor, not everything that is produced is sold, and if it is not sold there is no income.

The Court: But the testimony here does not show that any one of these articles are not sold?

The Witness: But your—

The Court: Bear in mind we are talking about only the segment of the business that is sold. We are talking about something here that the articles were sold, every one of these articles were sold and produced.

Now, then, every one of these articles were manufactured and they could not have been sold unless they were manufactured, so, if manufacture—and these are in Michigan—produce the article and the article produces the income or the sale, it seems to me that you could not have any income unless you had the production.

[fol. 249] The Witness: You are quite right, your Honor; but in the selling price you produce in order to sell at a profit, in terms of what price do you sell at, your price in terms of a variety of factors.

The Court: Bear in mind now, as far as we are concerned, we are "X" number of machines and equipment, we are not concerned with the truck that broke down on the way—

The Witness: Or the car boat that sank.

The Court: Or the boat that sank, we are not concerned with that. We are concerned with something that actually happened, and you could not have had that material unless it had been manufactured. It seems to me that it was necessary for the manufacture. You could not have had any income unless the articles were manufactured.

Now, these particular ones that were sold in the District—

The Witness: We are getting into a little bit of the semantics again, but basically, your Honor, the sales price in a company which is successful at selling its product at a profit, the sales price takes into account all of the factors that you are correctly pointing out are involved.

The Court: You are absolutely right about it, but I am talking about what was responsible for the X number of dollars of income that was earned from activities in the District.

The Witness: Then I have to go back to the three legged stool, your Honor.

[fol. 250] The Court: That is exactly what I thought, too.

The Witness: Which leg keeps the stool up.

The Court: I think all three legs keep it up. All right.

* * * * * * *

DONALD WATSON was called as a witness for the Respondent and, after having been duly sworn, was examined and testified as follows:

The Court: Doctor, give your full name and address to the reporter.

The Witness: Donald S. Watson, Box 419, Route 2, McLean, Virginia.

Direct examination.

By Mr. Wixon:

Q. Mr. Watson, where are you now employed?

A. At the George Washington University.

Q. In what capacity, sir?

A. Professor of economics.

Q. In what Department?

A. The Department of Economics.

Q. How long have you been so employed?

A. I have been employed at the George Washington University since 1935, and I have been full professor since 1948, sir.

Q. Have you had occasion to have engaged in the profession of teaching prior to your employment at George Washington?

[fol. 251] A. Yes, I had taught as a sub instructor at the University of California at Berkeley.

Q. Would you tell us, please, about your educational background?

A. Bachelor of Arts, University of British Columbia in 1930; Ph.D., University of California, Berkeley, 1935.

Q. Are you a member of any professional organizations related to the field of economics?

A. The American Economic Association.

Q. Have you written any books or pamphlets or articles—

A. Yes.

Q. (continuing) —in the field of economics?

A. I was co-author of a book on federal finance in 1940; co-author of a widely used text on the principles of economics published in 1948, with a second edition in 1953; in 1960 I published a book on economic policy.

Q. Could you give me the titles, sir, of those volumes?

A. The first one, 1940, Government Spending and Economic Expansion; the second one, 1948 and 1953, Modern Economics; the third one, Economic Policy, subtitled Business and Government.

The Court: Have you written any books on taxes?

The Witness: No, sir.

By Mr. Wixon:

Q. Have you outside of the field of your employment at the George Washington University had occasion to engage in activities relating to economics?

A. Yes, I have been consultant, a consultant to the operations research office of John Hopkins University; a con- [fol. 252] sultant to the Foreign Operations Administration, now the International Cooperation Administration; consultant to a tire dealers association; a consultant to the U. S. Chamber of Commerce.

Q. And that was as an economist, sir.

A. Yes.

Mr. Wixon: I take it, your Honor, there is no question about the qualifications of Professor Watson.

The Court: I would not say so. No objection made to his qualifications.

By Mr. Wixon:

Q. Professor Watson, I would like to read you a question which assumes certain facts as follows:

General Motors Corporation, the petitioner in this case, is engaged primarily in the manufacture and sale of auto-

mobiles, trucks and other motor vehicles, parts and accessories therefor and engines.

General Motors does not have any plant, does not conduct any manufacturing or assembly operations in the District of Columbia; General Motors does engage in regular and systematic promotion and selling of its products in the District to customers in the District and in liaison activities with its customers, including the United States of America, through offices located in the District and employees located in the District, and through traveling employees who come from time to time to the District; the activities of General Motors Corporation in respect of the promotion, sale and [fol. 253] distribution of its products in the District of Columbia are the same as its methods of promotion, selling and distribution of its products throughout the country.

During the year 1957, General Motors had total sales of its products amounting to $9,461,855,874; during that year General Motors' sales to customers of General Motors in the District and to whom shipments of products were made within the District amounted to $37,185,704; during the year 1958, General Motors had total sales of its products amounting to $7,853,393,381. During that year General Motors' sales to customers in the District of Columbia and to whom shipments were made within the District, amounted to $32,542,519.

The District of Columbia Income and Franchise Tax Act of 1947, as amended, which act was in effect during the years 1957 and 1958, and which act is applicable to General Motors Corporation, imposed a franchise tax upon General Motors Corporation at the rate of five per cent upon its taxable income for the privilege of carrying on or engaging in trade or business within the District and of receiving income from sources within the District.

In the case of a corporation such as General Motors which carries on a trade or business both within and without the District, the act provides that the measure of the franchise tax payable by the corporation shall be that portion of the net income of the corporation as is fairly attributable to [fol. 254] any trade or business carried on or engaged in by it within the District and such other net income as is derived from sources within the District.

The statute provides further that if the trade or business of a corporation is carried on or engaged in both within and without the District as is the case of General Motors, the net income of the corporation shall be deemed to be income from sources within and without the District, and in such case the portion of the net income subject to franchise tax shall be determined under regulation or regulations as prescribed by the Commissioners.

The total net income of General Motors required to be apportioned for purposes of District franchise tax under the Income and Franchise Tax Act of 1947 was $1,312,092,839 in 1957 and $653,396,893 in 1958.

In each of the years 1957 and 1958 the District of Columbia pursuant to regulation determined the portion of General Motors' total net income attributable to the trade or business carried on by General Motors within the District during those years by multiplying total net income by a fraction, the numerator of which was the dollar amount of sales by General Motors of its products to District Customers, which products were shipped to such customers in the District, and the denominator of which was the dollar amount of General Motors' sales of its products to its customers everywhere.

Assuming all of the following facts, do you have an opin-
[fol. 255] ion as to whether the method of apportionment of the net income of General Motors Corporation as used by the District of Columbia resulted in a reasonable approximation of the net income of General Motors which was fairly attributable to the business carried on by General Motors within the District of Columbia during the years 1957 and 1958?

The Court: Did you say to whom shipments were made within the District, or to the District?

I just want to be sure I am right. Shipments were made within the District?

Mr. Wixon: I would say this, sir—

The Court: I just don't know what anybody else said, I just was wondering where the facts were—

Mr. Wixon: I think your Honor is right in the sense of within as a circumscribed area—to the customers located within the District.

The Court: You already had that word. Sold to customers in the District, but you said they were shipped within the District.

I don't think there is any facts on that. But, of course, you are taking a chance if the facts are not as you state them, your testimony is impaired a little bit.

Mr. Wixon: Would your Honor indulge me just a moment? Except where necessary I chose to retain the language used in the hypothetical question put by counsel for General Motors to its witness.

[fol. 256]

* * * * * * *

"During the year 1957, General Motors had total sales of its products amounting to $9,461,855,874; during that year General Motors sales to customers in the District of Columbia to whom shipments were made in the District of Columbia amounted to $37,185,704. During the year 1958 General Motors had total sales of its products amounting to $7,853,393,381. During that year General Motors sales to customers in the District of Columbia to whom shipments were made in the District amounted to $32,542,519. The District of Columbia Income and Franchise Tax Act of 1947 as amended, which act was in effect during the years 1957 and 1958, and which act is applicable to General Motors Corporation imposed a franchise tax upon General Motors at the rate of five per cent upon its taxable income for the privilege of carrying on or engaging in trade or business within the District and of receiving income from sources within the District.

"In the case of a corporation such as General Motors which carries on a trade or business both within and without the District, the act provides that the measure of the franchise tax payable by the corporation shall be that portion [fol. 257] of the net income of the corporation as is fairly attributable to any trade or business carried on or engaged in by it within the District and such other net income as is derived from sources within the District.

"The statute provides further that if the trade or business of a corporation is carried on or engaged in both within and without the District as is the case of General Motors,

the net income of the corporation shall be deemed to be income from sources within and without the District, and in such case the portion of the net income subject to franchise shall be determined under regulation or regulations as prescribed by the Commissioners.

"The total net income of General Motors required to be apportioned for purposes of District franchise tax under the Income and Franchise Tax Act of 1947 was $1,312,092,839 in 1957, and $653,396,893 in 1958.

"In each of the years 1957 and 1958 the District of Columbia pursuant to regulation determined the portion of General Motors' total net income attributable to the trade or business carried on by General Motors within the District during those years by multiplying total net income by a fraction, the numerator of which was the dollar amount [fol. 258] of sales by General Motors of its products to District customers, which products were shipped to such customers in the District, and the denominator of which was the dollar amount of General Motors' sales of its products to its customers everywhere.

"Assuming all of the following facts, do you have an opinion as to whether the method of apportionment of the net income of General Motors Corporation as used by the District of Columbia resulted in a reasonable approximation of the net income of General Motors which was fairly attributable to the business carried on by General Motors within the District of Columbia during the years 1957 and 1958."

A. Yes, I do have an opinion.

Q. Would you please state, Professor Watson, what your opinion is?

A. My opinion is that the use of sales as a measure of net income is a reasonable approximation and, in fact, the best approximation available.

The Court: He means this particular one.

You say is a measure, but you mean exclusively, just one factor?

The Witness: Yes, your Honor.

[fol. 259] The Court: Don't consider anything but sales.

In other words, you think it properly gives to the District as sales in the District bears to sales everywhere?

The Witness: I believe that it is a reasonable measure of the net income caused by the District of Columbia sales.

The Court: I am sort of at a loss because I don't know as much about words as you professors do, and doctors, but all I ask you is do you think that the apportionment which is that there shall be apportioned to the District that proportion of net income as sales in the District or sales to District customers, rather, bear to sales everywhere.

Do you think that is the right thing?

The Witness: I think that is reasonable.

The Court: Well, do you think it is the best one?

The Witness: The best one available, yes.

By Mr. Wixon:

Q. Professor Watson, would you please state the basis or predicates for the opinion that you have just given?

A. Well, the bases for my opinion are these: the net income of a corporation, I defined as its gross dollar receipts which I shall henceforth call sales, minus its full costs. The net income is sales minus costs.

The Court: Also other things, aren't there?

The Witness: In my opinion, no, sir.

[fol. 260] The Court: You mean neither income does not reflect the deductions for overhead expenses?

The Witness: That is part of costs.

The Court: Oh, I thought you meant direct costs. All right; go ahead.

The Witness: Now, we have an equation here, sales, minus costs equals net revenue.

Now, both sales and costs themselves depend upon several factors. The sales, for example, of General Motors in the District of Columbia, depend upon the acceptance of General Motors products by buyers in the District, their taste for General Motors products, their sales depend upon the incomes of buyers in the District of Columbia, the sales depend upon the prices and the conditions of sale, they depend very much also upon competition from other manufacturers of similar products, and upon the quality of the competitive products and the prices of the competitive products.

Some of the products sold by General Motors in the District are durable goods, notably automobiles, and the sale of new automobiles is dependent upon the condition of the secondhand car market.

That, too, is a sales factor.

Now, on the costs side we have overhead, maintenance and depreciation, labor, materials, fuel, electricity, and so on, [fol. 261] all similar matters, and selling costs.

Now, to continue with the bases for my opinion: Ideally the best measure, it is not available but ideally and conceptually the best measure of the net income from sales in the District of Columbia would be to find out what would be the impact upon the total net income of the corporation from the loss, the entire loss of the sales in the District of Columbia.

These sales in the District of Columbia are in addition to total sales and conceptually the best measure of net income is to find what addition they make to the total net income.

That method, obviously, is unavailable.

Another method which is not available would be complete examination of the records of the corporation to find out if net income from sales in the District of Columbia is larger or smaller than the proportionate part.

In the absence of such information, then, I take the position that the net income from sales in the District of Columbia is proportionate, that is to say, proportionate—it has the same proportion as sales in the District to sales everywhere.

Now, to hold that view is to go along with a widespread practice of thinking and speaking and making decisions on net income as a percentage of sales, General Motors has many products and sells many products in the District of Columbia, no doubt in all probability the markup over costs varies a little from product to product, but taking them by [fol. 262] and large there is an average markup over costs and if the costs are defined as full costs as I defined them a few moments ago, then the average markup over the full costs is the net income and it must be very close, I mean it must be the same as on sales elsewhere.

Now, for that proposition to hold certain conditions are necessary. One is that the product mix that is the com-

position of the items sold in the District of Columbia be the same or very nearly the same as elsewhere.

Another condition that must hold, and I think it does, is the prices in the District of Columbia be the same as elsewhere.

Still another would be that selling costs per dollar of sales in the District of Columbia would have to be the same as elsewhere. It is possible, it is perhaps probable, that the net income from D. C. sales of a large corporation is larger than the proportionate share.

The grounds for holding this probability are that the District of Columbia is a good market, it has a high income, the income is stable. From the figures brought forward in this case we may notice that the decline in sales in the District of Columbia from 1957 to 1958 of General Motors was smaller, relatively, than the decline in total sales.

So the District, then, is a good market and if anything the net profits arising from sales in the District are slightly larger than the proportionate amount, but having no specific knowledge on that I will hold to the proportionality procedure.

[fol. 263] The Court: You say not having specific knowledge?

The Witness: No, sir; on grounds of reasoning, on the character of the market I hazard a guess as a probability that it might be, that neither income from D. C. sales is higher than the proportionate amount, but I don't know.

The Court: All right.

The Witness: Now, to conclude the statement of the bases, then the net income from the District of Columbia sales is best approximated by use of the so-called sales factor or sales formula, with costs as I have defined them exactly the same result would be obtained.

So, in view of the simplicity of the sales factor I repeat that it is the best approximation available for measuring net income from sales in the District of Columbia.

By Mr. Wixon:

Q. Professor Watson, would the inclusion or rather would the use of a type of formula for this purpose which had

the elements of property and payrolls alone in your opinion achieve a better measure of the portion of the income of General Motors which could be said to be fairly attributable to its trade or business within the District?

That is to say, just the use of the factors of property and payroll?

A. My answer is No, on the ground that although the use of property and payroll might commend itself for adminis-
[fol. 264] trative or political or other such reasons, it has—it cannot at all be justified on the grounds of economic logic.

Property means the value of the property of a company, net income arises from sales, minus full costs, and full costs, we can take them on an annual basis, are a flow of costs where a property is a stock, so that property is not a correct measure even of the capital part of the annual costs.

Payroll is part of costs, but property and payroll would omit the inclusion of purchased fuel, purchased energy, the advertising expense, that is payments to advertising companies and so on, so that property and payroll would not be an adequate measure of costs.

Property and payroll does not include sales and therefore,—

The Court: How about all three together?

The Witness: Well, your Honor, if all three together are used together they are weighted equally.

The Court: Yes.

The Witness: And such a weighting is, in my opinion, purely arbitrary, there is no logic, no rationalization that can be—

The Court: Suppose you rate it arbitrarily, say, give two points to twice the sales or twice that, how would you do it if you use the three factors?

The Witness: Speaking as an economist and not as a tax administrator, I know of no way to find logical weights for these three factors.

[fol. 265] The Court: Do you know what the formulas used in the majority of states is?

The Witness: I have a general impression.

The Court: Don't you know what it is?

The Witness: No, I do not have full knowledge.

The Court: You don't know what the uniform formula is, the conference of uniform state laws?

The Witness: No, sir; I do not.

. . . . . .

By Mr. Wixon:

Q. Would it make any difference to you, Professor Watson, if you were told that some States employed factors of payroll, property and sales with equal weight?

Would it make any difference in your conclusion?

A. No, I would not be the least impressed.

Q. Do you as an economist have knowledge concerning what changes in sales factors may cause changes in net income?

A. Yes, as I explained there are several sales factors, and, of course, the sales factors in one year can change in such a way as to make the net income negative, that is to say to cause the company to have a loss.

A change in the public acceptance of a corporation's [fol. 266] products can cause its net income to go up or down, is a change in its competitor's products and prices, selling methods, can cause a company's net income to go up or down, and so on.

The Court: The cost of materials?

The Witness: That also can change and cause a change—

The Court: Labor?

The Witness: Yes, labor costs, material costs, changes in these can cause changes in net income.

The Court: That is obvious, I'm not an economist but I think I know that.

The Witness: It is obvious to me, sir.

The Court: I'm sure it is.

By Mr. Wixon:

Q. Now, can it be said that one or the other of these two items is the more important causes of net income, sales or costs?

A. No, it cannot be said that one is more important than the other. The three, sales, costs and net income, are mutu-

ally determined. The famous figure of speech known to all economists is this, it is idle to debate whether it is the upper or the lower blade of a pair of scissors that cuts the paper, both cut it together, both sales and costs determine net income.

Q. Now, sir, if you measured net income by costs what type of a result would you be likely to obtain?

A. With the proportionate thesis to which I hold you [fol. 267] would get exactly the same type of result.

Q. And that is true, is it, sir, in respect of sales?

A. Yes, the same result as would be given by the use of sales.

Q. Well, sir, to sum to a degree, do you have an opinion as to whether the formula that I have stated to you in this question of sales is consistent with accepted economic principles?

The Court: He said—

Mr. Wixon: I don't think he has gotten to that exact point, sir.

The Court: He said that in his opinion that that was the right way to do it and the best way to do it, isn't it? He has already covered it. I think we are going over these things.

Mr. Wixon: I said accepted economic principles, sir.

The Court: I'm sure his views—

Mr. Wixon: Does your Honor have any objection to his answering the question?

The Court: Go ahead and answer it. Your view is an accepted economic principle and, therefore, any view you do have does have an accepted economic principle.

The Witness: My answer is, yes.

The Court: Yes, of course.

By Mr. Wixon:

Q. Professor Watson, do you have an opinion as to [fol. 268] whether net income of a corporation with a nationwide market can be said to originate in the place where the corporation manufactures its products?

A. No, I do not think it can be said logically that the net income of a corporation with a nationwide market origi-

nates in those few square miles where it happens to carry on its activities. Its market is nationwide, the sources of its labor force are no doubt from many States, its materials come from many States, many of them from foreign countries.

Such a corporation earns its net income as part of the entire economy, and on grounds of economic principles it makes little sense to try to look to the geographic origin. If the corporation moved its plant from one State to another, and corporations do that for cost reasons, its net income could still be the same and it would add nothing to a discussion of net income to try to locate its geographical origin.

Q. Taking the elements of capital and labor, as an economist would you say that these two items are the causes of net income?

A. No, they are not the causes of net income, they are part of the causes, the actions of consumers in accepting the products of a company. In being willing to pay the prices asked by the company they, too, are causes of net income.

Q. Do they create net incomes?

A. To the question as asked, my answer is, no, because net income is created on both sides of the equation, on both the cost side and the sales side.

The Court: You mean they alone don't create it?

[fol. 269] The Witness: Yes, your Honor.

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Cross examination.

By Mr. McGratty:

Q. Did I correctly understand you to say in answer to Mr. Wixon's hypothetical question that in your opinion the method employed by the District resulted in a fair approximation of the net income of General Motors attributable to the business which it carried on in the District?

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The Witness: Yes, when the word "fair" means "reasonable."

By Mr. McGratty:

Q. Now, in your opinion was that amount of net income arrived at in the manner outlined by Mr. Wixon attributable solely to the activities engaged in by General Motors within the District?

A. No.

Q. It was attributable, then, in part to District activities and in part to activities carried on outside the District; is that right?

A. The net income from sales in the District of Columbia is caused by the sales and by the costs. As I said before by full costs. Apparently General Motors incurs only part of its costs in the District of Columbia.

Q. Do I understand that it is your opinion that the portion of the total net income of General Motors fairly attributable to the activities which General Motors carries on within the District is that same proportion of total net income of General Motors as would be arrived at by taking [fol. 270] the total volume of District sales as a numerator and total sales everywhere as the denominator?

Is that right?

A. Yes.

Q. So, then, do I correctly understand that in your opinion there is fairly attributable to those activities which General Motors carries on in the District the entire net income attributable to those cars which are sold to residents within the District?

A. As an economist I am not interested in or concerned with the geographical location of General Motors activities. To me there is a total activity of producing and selling automobiles; the net income from any one batch of sales, I hold, is proportionate to the net income from any other batch of sales. So that the full costs, wherever incurred, in my opinion, are to be subtracted from the sales for any particular batch of sales to find the net income attributable to that batch.

Q. Well, I'm not sure whether you understand my question, let me repeat it once more.

In your opinion is the entire net income or net profit with respect to the cars sold to residents of the District of Colum-

bia attributable to those activities carried on by General Motors within the District?

A. No.

Q. So, in your opinion is only a portion of the total net [fol. 271] profit in respect of the cars delivered to the District of Columbia attributable to activities within the District?

A. Well, I must answer this way, that your question has to deal with costs and one canont attribute net income to any one part of costs. It can only take the whole cost together and subtract them from the whole sales to find the net income, so that the attribution or imputation of net income to one particular batch of costs—

The Court: He just asked for costs generally, he didn't ask you about any particular batch.

The Witness: The activities within the District of Columbia. To me that is part of total costs, the costs of those activities is part of the total cost.

By Mr. McGratty:

Q. If I understand you correctly a moment ago you testified in answer to my question that in your opinion the entire net profit in respect of the cars delivered into the District of Columbia could not be attributed to the activities engaged in within the District.

Now, did you not so testify?

A. I said no to that question.

Now, therefore, do I correctly infer that in your opinion a portion of that net income was attributable to activities conducted by General Motors outside the District?

A. In answer I can only say they have something to do with it.

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[fol. 272] By Mr. McGratty:

Q. In your opinion is any of the net profit earned in respect of the cars delivered to the District attributable to the engineering activities of the corporation in the engineering of those cars?

A. I take it you mean net income?

Q. I said net profit.

A. Well, I don't know because the engineering department may be working on something that will bear fruit seven years from now.

Q. Let's assume that these cars sold in the District had been engineered at cost, at substantial cost, in the State of Michigan. Would some of the net profit or net income in respect of those cars be attributable to the engineering activities engaged in in Michigan, in your opinion?

A. The engineering activities this year?

Q. Whenever performed.

The Court: Which the cars were manufactured?

The Witness: There is a time lag here.

The Court: I don't think that is important, do you?

The Witness: No.

By Mr. McGratty:

Q. If it will make it easier for you to answer, assume that everything takes place during the course of one calendar year, let us assume that the engineering, the car is engineered in Michigan in January and it is ultimately sold [fol. 273] in the District in December. Is part of the net income or profit from that car attributable, in your opinion, to the engineering activities in Michigan?

A. It could be if it were clearly shown that the engineering activity made the cars more attractive, more easily sold, so that, then, the engineering costs, together with the sales results have something to do with net profit. Net income.

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By Mr. McGratty:

Q. In your opinion, is some portion of the net income in respect of those cars delivered to the District attributable to the manufacturing activities with respect to that car in the State of Michigan?

A. Again the sales, some part can be—

The Court: Let's take the segment of the business relating to the District of Columbia. These particular X number of cars.

Now, what he means is would the manufacturer of those cars have anything to do—

The Witness: Well, yes, net income arises from sales and actual costs, manufacturing costs are part of full costs. So that they have something to do with it.

Mr. Wixon: May the witness finish, he said so that—

The Witness: They have something to do with net income.

By Mr. McGratty:

[fol. 274] Q. So, do I correctly understand you to say that all costs, whether it is engineering or manufacturing or administrative or other costs, all costs contribute to some extent to the net income?

The Court: With relation to the particular—

By Mr. McGratty:

Q. With relation to these particular cars that are delivered in the District?

A. They are one of the causes of net income.

Q. And do they all—is net income attributable, in your opinion, to all of these different—

A. After taking sales into account.

Q. Yes.

In other words, as I understand it your opinion is that net income is attributable to a number of factors, including engineering, manufacturing, assembly, administrative activities, and also the selling activities in the District?

A. (Nodded yes.)

The Court: The reporter can't get your head shaking.

The Witness: Yes, I'm sorry.

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By Mr. McGratty:

Q. And that is your opinion with respect to those automobiles which were sold to customers in the District?

A. Provided that we always keep in mind the actions of the consumers in the District, sales.

[fol. 275] Q. Do you mean that unless the consumer elected to purchase the car there would be no sale at all?

A. Yes.

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By Mr. McGratty:

Q. Do you have any opinion as to the proper way or the most appropriate way to determine what portion of the net income in respect of the cars sold to the District of Columbia residents is attributable to the manufacturing activities, to the engineering activities, to the administrative activities, and to the selling activities?

A. On that point I have no opinion in the sense that such a question is unanswerable with economic logic.

Q. In your opinion would one arrive at a reasonable approximation of the portion of net income respectively attributable to engineering, to manufacturing, to administrative, and to the selling activities in the District if one compared the relative costs of those different activities?

A. No, because they might make unequal contributions to total sales.

Q. By that do you mean that a dollar of engineering costs might make a greater contribution than a dollar of manufacturing costs?

A. That is quite conceivable. Also conceivable in reverse.

Q. And do I understand that in your opinion it is impossible to measure the relative contributions of these different [fol. 276] factors? Impossible as a practical matter?

A. It can always be settled by some arbitrary rule of thumb method.

Q. Yes, but as a practical matter in your opinion is it impossible to measure it with any degree of exactness?

A. A practical person can make up whatever answers he wants to. I can only say that on logical conceptual grounds,

given the information available and the premises introduced into the questions, your last question cannot be answered.

Q. Well, if that question cannot be answered would it be reasonable under those circumstances to make the assumption for practical purposes, that each dollar of costs contributes so much to income as each other dollar of costs?

A. I cannot answer that question without knowing the purpose for which such answers are desired.

See, definitions and matters like allocation and so on vary almost without limit, and the correctness of a definition or of a method of allocation depends upon the purpose at hand. So, to a question, does not each dollar of cost contribute an equal amount to net income, I can only say I don't know. If a purpose were given me then I might be able to answer.

Q. Well, let us assume that the purpose of our inquiry is to determine the relative proportions in which engineering, manufacturing, administration and selling contributed to the total net profit in respect of the cars delivered to the District of Columbia.

[fol. 277] Now, if we make the further assumption that the cost of each of those four activities was equal, 25 per cent of the cost for each activity, in your opinion, would it be reasonable to attribute 25 per cent of the total net income or profit in respect of those cars to engineering, 25 per cent to manufacturing, 25 per cent to administrative, and 25 per cent to selling?

A. I must say no because the factor of sales is omitted—

The Court: No,—

Mr. McGratty: I have included selling expenses.

The Witness: The gross receipts from consumers has been omitted because, suppose that the engineering department's costs are 25 per cent of the total; in 1957 conceivably, and I am still holding to the assumption several minutes ago that everything happens in one year, it is conceivable that the engineering department was so highly successful in designing the models sold in 1957 that its activities contributed more than some arbitrary proporationate share to the net income from the District of Columbia in that year.

Then conceivably also the District of Columbia consumers might have been more impressed by the activities or by the results on the cars themselves of the activities of the engineering department. So, the practical problems are often solved in the way you suggest in your question by equal arbitrary apportionment, but if I am asked as an economist what I think of it I must say that the answer to the ques-
[fol. 278] tion as asked is, no.

By Mr. McGratty:

Q. But if, as you point out, if in your opinion, it is as a practical matter impossible to determine the relative merits let us say, of the activities of each of these departments, would it, in your judgment, be reasonable to assume that the contribution of each was measured by the dollar costs of the activity?

A. For some purposes, yes, for the purpose at hand, the sales as an approximation of net income I would say, no.

Q. Well, now let me ask you this, in your opinion, did the engineering, manufacturing, administrative, and selling activities of the corporation account for 100 per cent of the net income or profit with respect to those cars sold in the District of Columbia?

A. No.

Q. In your opinion what percentage of the total net income is fairly attributable to those activities which we have listed?

The Court: He says he can't answer that.

Mr. McGratty: I didn't realize that that was his answer.

The Court: He says as an economist he can't do it. He says practically the people do it by some formulas, but he says he can't do it. He says it does but he can't tell the exact amount. Maybe the engineering was so successful that it produced more net income than any other.

Mr. McGratty: Maybe I hadn't made my last question
[fol. 279] clear to you, your Honor. And forgive me for repeating it if I may.

What I was asking or meant to ask was, in your opinion what percentage of the total profits was represented by the

or attributable to the aggregate activities of engineering, manufacturing—

The Court: He said he couldn't tell. You left out one important factor, that is sales.

Mr. McGratty: I had included the selling.

The Court: Oh, I didn't know you included the sales.

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Mr. McGratty: I'm speaking in terms of activities.

The Court: He is talking about activities of the corporation and he says these various activities—engineering, manufacturing, selling, all of those activities—they are called activities. I think the witness understands it, don't you?

The Witness: Yes.

By Mr. McGratty:

Q. And in your opinion do all of these activities taken in combination account for 100 per cent of the net profit or net income in respect of the cars sold in the District?

A. To the question as stated my answer is, no.

Q. In your opinion, is some portion of the net profit attributable to some other activity?

A. Yes; the activity of the people who buy the products of the company. They, namely sales, and costs together [fol. 280] mutually determine the net income of the corporation.

Now, in your opinion, or do you have any opinion, as to the percentage of total net income or profit in respect of the cars sold in the District is attributable to the activities of the buyers in the District?

A. No, I can only repeat the two sets of factors, sales and costs, are mutually determining. With the information available here nothing can be said as to which one contributes what percentage.

It can only be said that both together, simultaneously, mutually, determine the net income.

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By Mr. McGratty:

Q. Referring to the engineering, administrative, and manufacturing activities we were speaking of a moment ago I will ask you to indulge the assumption that all of those activities were engaged in and performed in the State of Michigan and that the selling activities were engaged in in the District of Columbia. In your opinion where does the corporation earn that portion of the net income in respect of these cars which may be attributed to the engineering activities engaged in in the State of Michigan?

A. The corporation earns its net income from its sales in the District of Columbia from the volume of those sales minus its costs of engineering, manufacturing, administration, et cetera, et cetera, and to me as an economist it makes no difference where production is carried on. If the physical [fol. 281] production processes are physically located in one State that fact to me is not particularly significant because those activities are still part of a great complex of the whole economy of the national market, so that if I must answer the question where I will say that the net income is earned where the sales in question are made, namely in the District of Columbia.

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Q. The entire net income you would say, in your opinion, was earned in the District of Columbia?

A. There were the consumers—you cannot make net income until you bring your product to market where the consumers are and sell it to the consumers in the market, where they are.

Q. And—

A. It makes no difference from how many distant miles you have to bring your product, you still have to bring it to the market—

The Court: How do you justify that with your testimony that some part of the net income is attributable to the activities?

The Witness: I confined my remarks, your Honor, to costs, wherever incurred.

The Court: Yes.

The Witness: They, full costs wherever incurred are one of the two determinations of net income, wherever incurred. [fol. 282] The Court: How do you justify saying that income, then, is earned entirely in the District?

The Witness: Because there is the market in question, the relevant market.

The Court: But you have already testified that these other activities, and counsel used activities, such as manufacturing, you even gave a very nice example about engineering, you had admitted that engineering contributed to costs, but you could not tell the exact amount it contributed, or percentage, because you said you would not know whether it was successful or not, and so forth, well, how do you justify the other?

The Witness: My opinion on the inconsequence of geographical location of production.

The Court: How about the inconsequence of geographical selling?

The Witness: Well, the one batch of sales has to be defined and it is defined as sales—

The Court: Why defining selling than any other activity? I can't understand, I want to understand your testimony, but I don't understand why you say selling has to have a geographical location and manufacture does not.

The Witness: Selling need not have a geographical location, the question might necessarily be about the net income [fol. 283] from Chevrolets as opposed to other products, then it would not matter in which state the cars were sold or which state they were assembled. The question of one batch of sales.

The Court: Do I understand it is where the customer is that you think—

The Witness: Where the customer is, there is the market.

The Court: Let's suppose that the sale does not take place in the District, it takes place to a customer, say, in Baltimore. Suppose a customer is in the District and someone tells him about a car, well, he comes to the conclusion he wants to buy a Chevrolet, someone tells him, out here in Bethesda, I know of my own knowledge, Chevrolet, you will get a good deal, he goes out there and deals.

Woud you say that has anything to do with the District of Columbia?

The Witness: Well, the question is, I take it, a legal question as to what District sales actually means.

The Court: I am talking about geography now. You are concerned with geography as far as sales are concerned but you are not with other activities. Now, what would be —let's take, there is a customer here in the District, he lives in the District but he goes across the line over to Bethesda and buys a car.

Do you think the fact that he is a customer that they should have that income earned in the District?

[fol. 284] The Witness: Are his sales over the District boundary part of the District of Columbia sales?

The Court: I asked you whether or not you thought the net income from that sale had its locale, whether it was earned in the District of Columbia because the customer was here?

The Witness: Your Honor, my answer was, Yes.

The Court: That income would be earned in the District? I mean, that is your theory of this—

The Witness: Yes; here we have a market called the District of Columbia sales.

Now, market is an economic concept. It can be defined in different ways for the purpose at hand now, defined geographically, so that the net income from sales in that market is then located in the corresponding geographic area.

The Court: Let me say this: Suppose you were the tax administrator of Maryland and you knew that a customer in the District went out and bought a car out in Maryland.

What would you do about the income earned from that sale out there? Wouldn't you insist as an economist that the income was earned out in Bethesda?

The Witness: As an economist I would say that Bethseda is part of the District of Columbia.

[fol. 285] The Court: Well, now, that throws a new light. All right, go ahead.

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The Court: Don't I understand your testimony to be that if the entire product of General Motors were sold to cus-

tomers in the District of Columbia that the entire net income of this corporation was earned in the District of Columbia?

The Witness: Yes, I so testified.

The Court: Now, then, let's take—then there is no difference in your mind as far as your testimony is concerned between the situation we now have here where only a very small portion of the products are sold in the District and where the entire products will be sold in the District?

The Witness: No, your Honor.

The Court: No difference.

Now, then, if you recall in the hypothetical question that was read to you by Mr. Wixon he stated that the law requires that if the business is carried on within and without the District that the income must be deemed to be within and without the District.

Do you follow me?

The Witness: I think so.

The Court: Do you know what that means?

[fol. 286] The Witness: I am not sure, your Honor.

The Court: Well, it certainly will mean, you will concede, won't you, that it means that some, but not all the income will go to the District?

The Witness: Yes.

The Court: But you are not certain about the proportions?

The Witness: I am not certain about the—

The Court: Let's take the language again, see if you understand it.

Where the business is carried on within and without the District, we are in a situation where General Motors has all of its products sold in the District, bear that in mind.

Now, then, the law says this, if the business is carried on within and without the District, which you must concede it is carried on within and without the District, the net income must be deemed to be from both within and without the District.

The Witness: Yes, your Honor.

The Court: So, it cannot be all from the District, can it?

The Witness: No, your Honor.

The Court: Well, then, the law Mr. Wixon read you had the provision and how do you justify your testimony that all of the income should be assigned to the District when it has that language in the question?

[fol. 287] You have just said that could not be so.

One minute you say all the net income must be apportioned to the District and yet when I call your attention to this provision—

The Witness: On the assumption that they sell only in the District and nowhere else?

The Court: Yes. Let me go again. Let me have it perfectly clear because this is the whole case really, to tell you the truth, in my mind, I think this is the most important part of the case.

In the hypothetical question, Mr. Wixon read a portion of the law which I am bound by, everybody else is, and it says that if the business is carried on within and without the District, the income must be apportioned part to the District, part outside. It does not say how much, it presupposes something reasonable, I suppose.

Now, General Motors—that is the law, I have got to follow it now, and General Motors manufactures all of its products outside the District, carries on business outside the District, it sells all of it in the District.

Now, how can you justify that under this provision of the law which says that if that is so the income must be divided between outside and inside the District?

The Witness: If General Motors has no sales outside the District—

The Court: No sales outside the District?

[fol. 288] The Witness: Then sales outside the District are zero.

The Court: Zero?

The Witness: So you apportion between a hundred per cent and zero.

The Court: But how long you—now, listen, some of the income, not zero, but the income must be deemed to be, the law says, from both Michigan, if all the manufacturing is there, and the District of Columbia.

Now, how can you justify that with your testimony here that the entire net income is earned in the District of

Columbia? Bear in mind that you had to answer the question according to what he read to you, and he read you this law. I think it slipped you.

The Witness: Your Honor, when the entire income is earned—

The Court: I did not ask you where the income is earned, I said everything is sold in the District—not sold to customers in the District, that is what the regulation says.

The Witness: I think there are two questions here. One is where did the net income arise—

The Court: I did not ask you that. I asked you under the law.

Now, Mr. Wixon asked you this question and he gave you this to answer, he says the law provides that where the parties are engaged, as they are here, both within and without the District, the net income must be apportioned or deemed to be from within and without the District.

[fol. 289] Now, my question again is, how do you justify you testimony in the light of that provision of the law?

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I ask you again, how do you justify your testimony when the law requires that if the business is carried on within and without the District it must be apportioned within and without the District?

The Witness: Under the assumptions of the question, your Honor, the sales are made only in the District.

The Court: Are only made in the District?

The Witness: So business is done in the District only?

The Court: No, it is not done, business is carried on in Michigan, the Company manufactures, it carries on business within and without the District.

The law assumes that they are going to have cases like that or it would not mention that provision, if every time a sale, means no other business carried on anywhere else there would not be any sense to the provision.

The Witness: Then my answer is that my testimony is inconsistent with the law.

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[fol. 290] The Court: Come to order. Mr. Wixon, are you ready to proceed?

Mr. Wixon: Yes, sir.

In the interest of time, your Honor, and if it will be acceptable both to the Court and to counsel for General Motors, I would like not to repeat or read the question that I put to the two prior witnesses in full. The witness has been in the courtroom, has heard it, knows it, and I think it may save time not to repeat it.

The Court: All right.

Mr. Wixon: Is that acceptable to you, sir?

Mr. McGratty: That's all right.

Mr. Wixon: With the understanding that the question for purposes of this case is repeated.

The Court: All right.

Thereupon, ROBERT R. NATHAN was called as a witness and being then and there duly sworn assumed the witness stand and, upon examination, testified as follows:

The Court: Give your full name and address to the reporter.

The Witness: My name is Robert R. Nathan. I live in Washington, D. C., and my office address is at 1218-16th St., Northwest.

Direct examination.

By Mr. Wixon:

[fol. 291] Q. Mr. Nathan, what is your present occupation?

A. My present occupation is consulting economist and I serve as President of a firm which serves in the consulting field; the name of the firm is Robert R. Nathan Associates, Inc.

Q. And that firm is located where, sir?

A. In Washington, D.C., the address is 1218-16th Street, Northwest.

Q. How long have you been engaged in the occupation just described, sir; that is with Robert R. Nathan?

A. I have engaged in consulting capacity with this firm since its inception in January 1946, some almost 17 years.

Q. Will you state, sir, your educational background?

A. I received my first training at the Wharton School of Finance and Commerce at the University of Pennsylvania, from which I received my Bachelor's degree, Bachelor of Science and Economics degree in 1931, and I remained on the staff at the University and received a Master of Arts Degree in Economics in 1933; then I studied law at Georgetown University and took an LLB. Degree in 1938 and thereafter took some further graduate courses in economics at Georgetown University.

Q. Are you a member of the Bar, sir?

A. Yes.

Q. Where are you admitted to the Bar, sir?

A. The District of Columbia, I do not engage in active practice of law.

Q. Would you please state, sir, what your activities em- [fol. 292] ploymentwise have been since you graduated from the University of Pennsylvania in 1933?

A. Well, if I may summarize briefly in addition to my work in the field of economics and research at the University of Pennsylvania I spent most of my succeeding years until going into private practice in the government service where I was first in the Department of Commerce working in the field of national income. I was Chief of the National Income Division of the Department of Commerce for many years. Also during that period I served as consultant to the President's Committee on economic security which set up our Social Security laws, and also for a short period left the government in Washington to work as assistant director of research of the State Emergency Relief Board of Pennsylvania.

In 1940 I left the position as Chief of the National Income Division of the Department of Commerce to enter the war agencies and served as Assistant Director of Research in the Defense Advisories Commission, the Office of Production Management, the Supplies Priorities and Allocation Board, and then became Chairman of the Planning Committee of the War Production Board. Then after some service in the Army I returned to government as Deputy

Director of the Office of War Mobilization and Reconversion from which position I resigned December 31, 1945, and entered my own consulting work commencing in January 1946.

[fol. 293] Q. Have you ever had occasion to be engaged as an economic consultant to any foreign governments?

A. Yes. The firm of which I am head has served in an economic advisory capacity to Burma, Korea, Israel, Colombia, Viet Nam, El Salvador, Ghana, and also we have done considerable work in Puerto Rico.

I think that encompasses all. There may be others but we have done considerable economic survey and advisory consulting work in many foreign countries.

Q. And has that been in the general field of economics, sir?

A. In most countries we have served in a general advisory capacity as economic planners, policy advisors, and economic implementers as well.

Q. Now, have you had occasion, sir, to write any treatises on the subject of economics?

A. Yes. I am author of a book called "Mobilizing for Abundance"; I was author of a publication in the Department of Commerce, as a matter of fact several publications, in the field of national income, one was, National Income in the United States, 1929-35; another one, National Income, 1929-36. I was co-author of a study called, "Palestine Problem and Promise," a study of the economic potentialities of Palestine, and I have been the author of other publications, National Wage Policy in 1949, and other pamphlets and reports.

Q. Have you had occasion to contribute to any magazines or publications having general circulation?

A. Yes, I have written for many technical as well as [fol. 294] policy journals, public and technical journals over the years, a good many publications.

Q. And I take it those were in the field of economics?

A. Almost entirely in the field of economics, mostly in the policy of planning economics field; yes, sir.

Q. Do you belong to any associations, sir, related to your field?

A. Yes. I am a member of the American Economic Association; I am a member of the American Statistical Association; and a past vice president of that association, and a fellow of that. I am also a member of the National Planning Association; I'm on the Board of Trustees of the Committee for Economic Development, and I was a member of the National Commission on Money and Credit which recently concluded three years of analysis and study of our whole money and credit system which incorporated work in the field of fiscal policy as well as monetary and credit policy.

Mr. Wixon: Unless there is objection, your Honor, I would submit to the Court that this gentleman is well qualified.

The Court: I hear no objection.

Mr. Wixon: Will counsel concede the qualifications?

The Court: They haven't objected to it. I don't know whether you concede it.

Mr. Wixon: I will take it they have conceded it.

[fol. 295] The Court: If they had objected they would have qualified it.

Mr. Wixon: All right.

By Mr. Wixon:

Q. Mr. Nathan, as you heard, in order to conserve the time of all concerned, I shall not read in full the question which I propounded to your predecessor witnesses. I understand you are familiar with the facts set forth in it, have heard the question, and understand it fully?

A. I have heard the question twice today; yes, sir.

Q. Now, assuming the facts, Mr. Nathan, that are set forth or were in the questions as previously propounded, do you have an opinion as to whether the method of apportionment of the net income of General Motors Corporation as used by the District of Columbia, resulted in a reasonable approximation of the net income of General Motors which was fairly attributable to the business carried on by General Motors within the District of Columbia during the years 1957 and 1958?

A. Yes, I do.

Q. Would you state that opinion, please, sir.

A. My opinion is that the formula and its application does provide a reasonable result related to the objectives set forth in the question.

Q. Would you please explain the basis for the opinion you have just expressed?

A. Very well.

The question of apportionment or allocation is at best a [fol. 296] very difficult one. Our economy is an exceedingly complex one and any attempt to attribute profits or profitability to any specific isolated influence or influences, it seems to me, is bound to encompass or encounter many difficulties, and from an economic point of view the difficulty of applying practical data and meaningful results in the face of the complexity of the economy necessitates that one tries to arrive at something which is reasonable, something that fairly approximates an apportionment which is sought.

Now, in our economic life profits, as with production, derive from a great many influences; profits perhaps even more than from products and net income or profits which we use interchangeably cannot in a truly meaningful sense be precisely allocated to any specific element. Profitability may derive not just from the excellence of a product and its price relative to other products, but it may derive from a wide variety of what might appear even to be extraneous circumstances.

We live in an economy that has continuing activities that interrelate and one influences the other.

For instance, in the production of goods and services there are payrolls, there are material purchases, and the material producers in turn have payroll, there are profits, there are dividends, there are interests, these in turn generate income. This income is buying power.

The Court: Factories, too?

[fol. 297] The Witness: Factories, everything relates in a sense to everything else.

It seems to me that the problem of looking at our over-all aggregate economy and economic activity is to try somewhere, within that continuous stream, to catch a measure of flow which is meaningful and reasonable and approx-

imate what one seeks to measure, and it depends on what the purpose of that allocation is.

Now, in the national income analysis the field in which I think I made some contribution in a pioneering way, we try to measure there what the production of the country is. One can measure the production of a country by taking the finished products and evaluating those—all the shoes, all the automobiles, all the haircuts, all the dental services—add up this big pile of goods and services and say, this is the measure of the production of the country.

Another way it can be measured is by measuring the various payments made for different factors of production which I have heard discussed today—wages, salaries, interest, dividends, rent, net profits.

Another way it can be measured by expenditures—what the total consumer expeenditures are, what the total producer expenditures are, what government expenditures are.

I illustrate this because one can arrive at a measure of national income or gross product by tapping or measuring [fol. 298] different items or different manifestations—

The Court: On activities.

The Witness: Or activities.

In a real sense it seems to me that in view of the fact that profits, profitability, net income, is such a variable because in a real sense it is a residual. A business like General Motors goes into producing cars, goes into producing refrigerators, goes into producing batteries, and in some years it makes a lot of money, and in some years it makes little money.

These variations in profit aren't always attributable to the creative genius or lack of genius of one year relative to the others.

The Court: Sometimes.

The Witness: In 1932, I would say, your Honor, that General Motors' management had just as much talent as it had in '29.

The Court: Lots of times they manufacture cars that don't appeal to the people.

The Witness: It may not appeal to the people, or the customer may have certain changes in demand. For in-

stance, we saw in recent years where apparently the customers wanted smaller cars, and the manufacturers didn't seem to respond to it, so we have had an import of a half a million cars. We have all kinds of factors affecting profitability, some of which seem to be spurious from time to time, your Honor, some seem to be attributable more under [fol. 299] certain circumstances to specific activities of management.

As a result of this I feel that it's—while one could conceivably come up with some kind of formula which took all these factors into account, I honestly think that from a practical point of view it's impossible to arrive at a conglomerate aggregate formula which would take into consideration all of those elements which influence and determine the level of profits or profitability.

The Court: Have you studied the uniform formula?

The Witness: Yes, I have, sir. I would like to come to that.

I think that there are elements of complexity of administration and also elements of arbitrariness in the tripartite formula, the three elements, which in many ways are just as arbitrary, perhaps more arbitrary, than the use of a single formula.

I would not say here, your Honor, that the sales as a basis is the only one by any means. Although I do feel very strongly that without selling you don't have revenue, you don't have profits, but I do think that it certainly is a reasonable basis for apportionment and when one takes into consideration the possibilities of factors entering into profits which really would be awfully difficult to measure, then I think it's appropriate to select that criterion or that formula which is reasonable and administratively feasible, and fair in the aggregate.

[fol. 300] The Court: You know what the formula is?

The Witness: Yes, the present formula?

The Court: Yes.

The Witness: Yes, that is to take sales of General Motors in the District of Columbia to total sales—

The Court: No, sales to customers—

The Witness: Sales to customers in the District of Columbia to total sales applied to total net income.

The Court: And you think that if all the entire product of the General Motors, now, was in the District of Columbia—

The Witness: Sold in the District of Columbia.

The Court: Wisconsin wouldn't have the right to tax but the District could tax a hundred per cent. That's your view?

The Witness: Let me say this, your Honor, if every jurisdiction—one of the problems that arises here, your Honor, that is the subject of concern, I gather is that on the one hand one would seek a formula which would be fair to the manufacturer. Now, if every jurisdiction, if every jurisdiction adopted the sales formula then 100 percent of the net income would be subject to the District of Columbia tax; that's correct.

The Court: But they don't do it.

The Witness: Now, of course, this poses a serious question.

On the other hand, if every jurisdiction adopted a formula that took, say, only physical plant in that area, or labor—

[fol. 301] The Court: It would be wrong.

The Witness: It would be wrong. There would be an element of arbitrariness depending on a wide variety of factors.

The Court: Let's take this. If every state adopted the uniform formula, which the manufacturers have fought, I'm sorry to say, then it would be fair, wouldn't it?

The Witness: It would be fair to the taxpayer, yes, sir.

The Court: Everybody.

The Witness: Then, certainly my feeling is, your Honor, that if a uniform formula of sales were adopted—

The Court: But the manufacturing states wouldn't get any income.

The Witness: Except this, your Honor, that in the manufacturing states you have employment, you have payrolls, you have higher per capita income relative to other states, these then become buyers, and as they buy products produced in other states, or from their own states, then the sales formula takes into account their income, your Honor.

You see, that's why I said before, your Honor, this is a continuing kind of economic process. General Motors employs lots of people in Detroit, their wage level relative to Georgia is quite high.

The Court: Let me say this. We are dealing now with a specific business, and it's taxed by all the other states, most of the states in which it does business, as far as I know all the states it does business, and yet you would say that if all [fol. 302] of its products were sold in the District that the entire net income was attributable to the activities, none was attributable to the work done in Michigan?

The Witness: I wouldn't say, your Honor, that the entire income is attributable to the District of Columbia.

The Court: That's what the formula says.

The Witness: The formula says this is a reasonable approximation—

The Court: No it doesn't.

The Witness: Fairly attributable. Well, I would say this; I honestly, your Honor, don't know of any formula that would be better in a real sense over-all than this.

The Court: Let me ask you this.

If all the income from this business, I mean of all the sales here, that you think it would be fair? Do you mean the entire net income is fairly attributable and none is fairly attributable to manufacturing, engineering?

The Witness: In absolute terms, no, I don't think it would be. In absolute terms to say that it's all 100 percent attributable to the District of Columbia's activities and zero to Michigan, I would say, no.

The Court: That's what this contemplates.

The Witness: Yes, if one is dealing in absolute terms. But I say, your Honor, that I think this more nearly approximates this objective of what's fairly attributable than [fol. 303] any other formula.

The Court: You would hold the same whether the entire net income or just a segment, I mean the entire sales or just a segment, your theory wouldn't change? I mean, we are dealing here with just a segment of their business.

The Witness: That's right, I would say the same.

The Court: It would be the same whether it was the entire thing or this?

The Witness: Yes.

The Court: Mr. Wixon, I'm sorry to interrupt you but go ahead.

The Witness: If I may conclude this one observation. It will take just a moment, but to illustrate why I think this is as good an approximation as any and reasonable and it should be given support and makes sense as if one were to take, for instance, if I may just digress for a moment—if one were to take just labor and capital, one raises a great, great variety of questions that I think in many ways are bound to bring in more arbitrariness than the sales formula.

For instance, take in the area—

The Court: What about the three?

The Witness: But the three are the sum of the individuals, your Honor.

In the first place, let's take capital of the one of the three. [fol. 304] Where does capital make its contribution? Is it the ownership of capital or where the manifestation of the investment exists? If the man who were to put up all the money for a General Motors plant in Detroit lived in Ohio one might fairly ask, is that capital income, or the income on capital fairly attributable to Michigan or to Ohio?

Let me put it another way. Let us assume that you had two automobile companies, one automobile company in Detroit made all of its components right down from the steel on through, had a huge capital investment there. Let us say there's another automobile plant which contracted out all of the manufacture of components and it contracted it out in such a way as often unfortunately in our imperfect competitive society in which we live where they often can influence the price and the profits, as we have seen and observed.

Now, the net profits of the two companies, your Honor, may be exactly the same, and the volume of business may be the same, but the amount of capital investment in the one company is a fraction of the other.

Now you only can get a hold of the net income of that capital, you cannot get a hold of the net income of the subcontractors.

The Court: We are not talking about capital alone, we are talking about factors.

The Witness: The deficiency of a combination of factors, [fol. 305] your Honor, I believe, in a sense is a summation of the deficiencies of each factor, and the problems that one has in allocating capital or labor or sales will associate to a combination of sales, labor and capital, and in a sense, your Honor, I think it is compounded, the difficulties, by the problem of weighting.

We know that in the aggregate of American economic activity labor, as a cost, is 3, 4, 5 times what capital is as a cost. In some industries it varies tremendously, in some industries capital cost equals labor cost.

In some industries labor costs 12 times capital cost.

In this combination of formula under these circumstances, your Honor, is there any logic for one-third labor and one-third capital?

The Court: If your capital is larger in that state as compared to the capital in another place, it would be—

The Witness: But it is within the state, the ratio of capital to labor. You see, your Honor, in certain industries —take the utility industries, very clear, one that has power and it may distribute it over several states.

In the electrical industry the ratio of labor cost, that is wages and salaries, to capital costs, interest, dividends, by the way profit enters in as a measure of capital cost, the ratio of labor cost to these others is rather low in a public utility as compared, say, with a handicraft industry where labor costs may be 12, 15 times.

Now, if one says that one is going to use one-third labor, [fol. 306] one-third sales, and one-third capital, this, it seems to me, has an element of arbitrariness in applying it to an industry where literally labor costs equal dollar for dollar with capital cost and apply that similarly in an industry where labor costs are ten to one.

The Court: I am very much interested in your testimony but I sort of cannot understand your concern for arbitrariness for the three factor formula and not for the one factor formula.

I think that is even worse.

The Witness: Your Honor, there is an element of arbitrariness in every formula.

I would not want to give the impression here, your Honor, at all, that sales has no element of unreality in the kind of a—I think largely unrealistic illustration that exists, of all manufacturing in one jurisdiction and all sales in another.

In those circumstances one finds an arbitrary element.

The Court: You said there is no difference between dealing with a segment and dealing with the entire thing?

The Witness: Well, except that I feel that in the sales, the limitations, the difficulties that are entailed in the use of the sales formula exclusively from I think from the point of view of equity, from the point of view of reasonableness, to the equity to the taxpayer, to the jurisdiction, I think involves less arbitrariness than the other combinations.

[fol. 307] This is my judgment from the economic point of view, your Honor.

The Court: Go ahead, Mr. Wixon, have you finished?

By Mr. Wixon:

Q. Does the sales formula have any positive advantages that you could point to as against other approaches such as the multiple three factor formula that Judge Morgan quoted?

A. I think one of the most important positive aspects of the sales formula does lie in the fact that sales in a real sense reflects purchasing power of people, if people do not have money they have no money to spend, if they have money they have money to spend and they do tend to spend.

Purchasing power in turn does reflect labor income and property income so that sales come nearer to approximating the final activity in this constant circle of economic activity in our life that we have, and from that point of view it tends to encompass things that take place in production, in distribution, in transportation and everything.

Secondly, I think that while there are problems of definition I think from the administrative point of view it has less complexity, certainly, than the profit side, and I believe that it has one further advantage which may or may not be applicable to this particular line, although I think it is from an economic point of view, and that is that it has some

relationship to that for which Government taxes are placed or assessed, namely, services rendered.

[fol. 308] We live in a society in which prices of products produced by the private economy are determined conceptually in the market place; taxation is determined in the executive level of government, and it relates to getting money from the public for services rendered to the public.

I think that taking it in relation to sales does in a sense relate it to those for whom the services are rendered.

So I think it has many positive advantages from those points of view.

Q. Will you discuss, Mr. Nathan, what your views in respect of the sales factor formula are as they relate to the taxpayer, whether as to the taxpayer it is a reasonable or unreasonable approach?

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The Witness: Looking first from the taxpayer's point of view, the question of the reasonable results, it seems to me, depend in a sense on the uniformity of the formula.

If you have a different formula applied in every different jurisdiction then one could easily conclude that any formula in any jurisdiction is unfair because the summation of the different formulas in different jurisdictions may add up to more than 100 per cent of the net income of the customer.

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The Court: That was not the theory in the Hans Rees case. They said they did a small amount of business and they were charged a large percentage of the income. That was not the question of any other state at all.

[fol. 309] The Witness: In this particular point from the point of view, however, of the taxpayer, I do believe, your Honor, that the state's proportion provides a fair basis in view of the fact that the taxpayer, in this case General Motors, derives certain considerable benefits from the Government activities in the District of Columbia.

The fact that we have a large, aggressive consumer market here, that we have a growing market, that it is a stable market, that it is a high per capita income market, that the assessments being placed in the District of Columbia relate

to providing services for Government personnel living here who in turn provide an ample, adequate, aggressive high level, high income market for the General Motors seems to me clearly to justify the use of sales as a criterion for allocation.

The Court: That is all reflected in the amount of sales?

The Witness: That is correct, sir.

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The Court: Do you mean to tell me you think this is fair in the District of Columbia and not fair in Maryland?

The Witness: Well, they have sales in Maryland just the same.

The Court: You think this theory would apply to Maryland?

The Witness: I think the sales formula would be fair in Maryland.

[fol. 310] The Court: They do not have the situation of the Government clerks and things like that over there.

The Witness: It is in the District of Columbia that it is eminently more fair than any other jurisdiction because you don't have, if I may say, your greatest single employer in the District is not a taxpayer and is not subject to that tax.

The Court: Do you think this theory you have about the District formula would apply fairly to sales in New Jersey?

The Witness: Yes, not to the degree we have here. I think it is in a formula which could apply fairly everywhere, your Honor.

The Court: Then this idea about the government business and so forth does not affect—

The Witness: It just makes it, in my judgment, eminently more fair here in the District.

The Court: All right.

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Cross examination.

By Mr. McGratty:

Q. Mr. Nathan, do I understand correctly that it is your opinion that the net income or net profit of a corporation is derived from a number of different factors?

A. A wide variety of factors, yes, sir.

Q. And would those factors include all of the engineering, manufacturing, administrative, selling and other ac-
[fol. 311] tivities of the corporation?

A. Everything the corporation engaged in can affect and does affect, may affect the profits of the company, the net income, yes.

Q. And do all of those factors which I have mentioned contribute in some measure to the net income of the corporation?

A. Yes, and no. They may contribute to losses, or they may contribute to profits, and there is no way in my judgment of saying that any specific factor has contributed any specific proportion to the net income.

Q. Now, you say that in addition, or do I understand you to say that in addition to the various activities of the corporation resulting in the production of the end product there are other factors which contribute to the net income of the corporation?

A. That affect the net income of the corporation, affect it very significantly.

Q. Would you say that the income of the corporation is attributable in part to these other factors?

A. Of course, this depends on the word "attributable." It is just like saying in 1942 did our war economy, was the profits of business attributable to that.

I think in a certain definition one could say Yes, that profits of business in 1942 were in some elements attributable to. I don't know whether one would say it was contributed by, but certainly in some elements it was attributable to, yes, using this in a generic sense.

Q. What other factors, in your opinion, in addition to the
[fol. 312] various activities of the corporation itself, contribute to the net income of the corporation?

A. The most important one of which is overall level of economic activity of the economy. In 1954—

Q. Excuse me, just list them without going into it.

A. The overall level of the economic activity of the country.

Q. That is one factor that in your opinion affects the net income of the corporation?

A. Very important.

Q. What other factors, in your opinion?

A. Our international economic arrangements and relationships, changes in the trade, imports and exports, sir.

Q. Are there any other factors in your opinion?

A. Yes, I think weather might be a factor in a given time that would influence the profits of a company.

Q. Now, I take it or do I correctly understand you to express the opinion that it is impossible as a practical matter to determine with any degree of certainty what contribution to the net income of the corporation is made by the weather or by international relationships or the general economic climate or the various activities of the corporation?

A. I think—yes, that is a fair conclusion of what I would say.

Q. But the net income, in your opinion, is attributable to a greater or lesser extent to each of these factors?

A. Some positive and some negative; yes.

[fol. 313] Q. Is it possible to measure in any way the extent of the contribution to net income by the various activities carried on by the corporation?

A. In my judgment it is not. It is not conceptually nor practically.

Q. In your opinion do the costs incurred in the conduct of each of these different activities not furnish any reasonable reflection of the contribution of those activities toward the net profit?

A. I do not believe they do. I think they are a measure of the contribution in the productive process, but to net profits I would say I do not believe they do, sir.

Q. But it is possible to determine, is it not, the cost of the different activities engaged in by the corporation in producing the end product?

A. Yes, sir, it is possible to estimate the cost.

* * * * * * *

Q. Well, since it is possible to determine the cost of the activities carried on by the corporation itself in the production of its profit and the realization of net income do you still feel that it is a more reasonable method to use the

sales factor without reference to the cost figures which are available?

A. Yes, I do.

Q. Now, let's go back to the question that the Court itself put to several of the witnesses and that is, assume the situation where all of the activities of the corporation are engaged in Michigan, all manufacturing and everything else done there, except the selling of the cars which is conducted in the District of Columbia, and that all of the cars [fo] 814] are bought by residents of the District of Columbia.

In your opinion, is none of the income of General Motors Corporation earned in Michigan where all activities except the sales activities are carried on?

A. I would say the earnings, and I assume you are talking about profits, net income?

Q. Yes, sir.

A. Certainly in part is attributable to every aspect of economic activity and to the extent that the formula would put all the net income into the District of Columbia, to that extent one might say that it deviates from some rational allocation taking into account as many factors as one conceivably could, but I still believe that the application of that across the lot would not violate an apportionment on every factor by any major, major degree.

In other words, one could still come back and say, without those sales in the District the operation in Michigan would be meaningless.

The Court: Without the production—

The Witness: Without the production you couldn't have any sales in the District; that is correct, your Honor. One I think I could develop illustrations frankly which would appear to be just as arbitrary in their application from any other formulas from this one, and in view thereof and the simplicity of it I think that even though there may be extremes where it would not appear to be applicable I still think it is the best.

By Mr. McGratty:

[fol. 315] Q. You spoke a moment ago of the contribution of the governmental facilities in the District to General Motors within the District as a basis for justification of application of the single factor sales formula.

Now, suppose you were to assume that General Motors Corporation had in the State of Michigan a hundred million dollars worth of elaborate plant and property, a great number of employees there, receiving the benefit of fire, police, availability of courts and all the other services by—furnished by the State of Michigan; and let's assume that in the District of Columbia it had a relatively small amount of real estate, let's say a hundred thousand dollars, and a relatively small number of employees, so that the facilities furnished by the District to the District employees, in the District were much less than those furnished by the State of Michigan.

And if all of the sales were made in the District of Columbia is it still your opinion that the application and use of the single factor sales formula is still the most fair and reasonable method of apportionment that you know of?

A. Yes, if I may I would say two reasons if I may, sir.

One is if this formula were applied all over we must realize that these hundred thousand employees of General Motors, or the employees associated, I think you mentioned a hundred million dollars worth of investment, the employees associated with that really have very substantial [fol. 316] buying power, they have good wages, good employment, considerable continuity, they would be buying products there not just from General Motors but from other sales and on the same formula Michigan would have access to net income of companies that were selling to these people whose income derived from General Motors, so that in a real sense Michigan, then, has access to the benefits of the production derived from General Motors.

The Court: But they also protect their properties, maybe the people in Michigan would get higher wages if they didn't have to pay taxes in all the different states.

The Witness: You mean—

The Court: The corporations.

The Witness: Yes, of course, on the other hand—

The Court: You know, after all, a corporation, you economists may regard it as something dead or lifeless—

The Witness: It is very alive.

The Court: But it is made up of human beings.

The Witness: It certainly is.

The Court: You are burdening them unjustly.

The Witness: We would all like lower taxes, your Honor, I'm sure, but we all would like Russia to behave better so we would have lower taxes.

[fol. 317] The Court: We think we protect you, we have fire protection, we have police and everything, we think you ought to pay, you have a big plant here.

The Witness: I think that it is proper that it should be apportion—a proportion of the net income paid in Michigan—

The Court: They don't do it under this formula.

The Witness: You mean if it had no sales there at all, you mean under your assumption?

The Court: I am taking your theory, you told me there was no difference between application of this formula with respect to a situation where all the products were sold, yet only where a segment of it, after all, we are only dealing with the segment of business of goods that are manufactured in other States are sold here in the District, but you say there is no difference in the theory, your application of the formula it doesn't make any difference whether it is all or part of the business.

The Witness: No, the application would have some difference, your Honor, I didn't mean to say it wouldn't because certainly in the case in which you, the illustration which you presented, your Honor, of all produced in Michigan, and all sold in the District of Columbia—

The Court: You say the formula—

The Witness: Under the sales formula all the net income would be subject in the District of Columbia.

[fol. 318] The Court: And you say that is fair?

The Witness: I say that is a fair approximation even though in that specific instance it does appear to violate what one would call a fairly attributable—

The Court: But you said there would be no difference in respect if it is the same, and we are dealing with a segment of their business.

The Witness: Well I thought when you said the segments you meant the gment of the company's business.

The Court: Yes. Let's say that 50 per cent of their business—that 50 per cent of the cars manufactured were manufactured in Michigan, sold in the District, would your formula apply there?

The Witness: Yes.

The Court: And suppose 25 per cent?

The Witness: It would apply.

The Court: All right, then, why do you say it isn't fair if the entire?

The Witness: Because, in the entire you get to an extreme, your Honor, where you show that no revenue presumably is used.

The Court: When you get to the acid test it shows up—

The Witness: I think in every formula—I honestly believe, your Honor, I could give you an illustration and the tripartite—

The Court: I know every formula is arbitrary. I am [fol. 319] trying to get at it, I am surprised at the other witnesses saying there is no difference in the application of the formula to the entire business and the segment we are here confronted with.

The Witness: It is good, and I could say, of course, to the extent that they are able to sell all their product in the District of Columbia and benefits from that sale to the extent they employ people, therefore, there is buying power in their economy, therefore, they buy products from producers in their States and other States and they get revenue from the sales.

The Court: I want to be clear about it. I understand you to say first and I asked you, whether there was any difference in the application of the District formula where the entire product is sold in the District and where only part of their products are sold.

The Witness: I said there is no difference.

The Court: Yes, sir.

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The Court: I want to ask you the same question I asked the other witnesses because I don't think you heard it.

Mr. Wixon had read a hypothetical question into which certain facts and provisions of law were cited, then he asked the question whether in view of those facts and provisions of law you thought the formula that the District used, which was that the District should tax that portion of the net [fol. 320] income that sales in the District bear to sales everywhere was fair and reasonable.

Now, in that hypothetical question you evidently overlooked this provision of the law which said that if the company is—if the taxpayer is engaged in business within and without the District, it doesn't make any difference about economics or anything else, it has got to be apportioned or at least deemed to be income within and without the District.

Now, do you agree with me that it is impossible to follow that provision with this one factor formula?

Mr. Wixon: If your Honor please, might I suggest that you advise the witness of your ruling in respect of the word "deemed".

The Court: Yes. Deemed means, I considered it, it is considered to be income, as far as this case is concerned it is considered to be income from both within and without the District.

Now, how can you follow that provision of law with a one factor formula?

The Witness: Wouldn't—it seems to me, your Honor, it depends on how you would define business activity. If you define business activity in sales, if this were the definition under the interpretation of the law, then it seems to me purely—

The Court: There wouldn't be any sense because you are always dealing with somebody making sales in the District and there wouldn't be any sense to that provision because [fol. 321] it contemplates that a person who is selling has business another place.

* * * * * * *

If you have one factor formula of sales you couldn't apportion or you couldn't consider or it couldn't be deemed to be income in the place of manufacture, could it?

The Witness: That is right.

The Court: And you couldn't follow that provision of the law, could you?

The Witness: That is right, you would find an inconsistency, then, between having to have within and without and defining doing business as sales, yes.

The Court: How about doing business as a manufacturer, isn't that doing business? Isn't that business?

The Witness: Yes, of course, as I said if you define for tax purposes—

Mr. Wixon: May he finish?

The Court: Don't you consider that General Motors engaged in business within and without the District?

The Witness: Oh, absolutely, sir.

The Court: Well, then, let's take the net income from this business we are here concerned with, the X number of products that are sold in the District. Now, how can we follow the law if we used—for instance, if we used a [fol. 322] property factor we wouldn't be able to follow the law because we would give all the income to Michigan.

If we used the one factor formula for sales we give it all to the District.

The Witness: That is right, sir.

The Court: So, we can't follow the law with that one factor formula, can we?

The Witness: I don't think so if your illustration applies.

The Court: You mean if it is held that manufacturing by General Motors is not business?

The Witness: Well, all I—

The Court: Isn't that right?

The Witness: No, if one says that the law says that it should be apportioned doing business within and without, shall be apportioned, but we regard sales as evidence of doing business.

The Court: Yes, but—

The Witness: See what I mean? You define in a sense, your Honor, you can define.

The Court: There is nothing in the law to justify it.

The Witness: I'm not sure it would be arbitrary to define it. I agree, your Honor, if you did you then would not be able to tax that manufacturing activity.

[fol. 323] The Court: When it is carrying on business within and without the District. Don't you think members of Congress considered a manufacturing company, manufacturing automobiles as a business?

The Witness: That is right.

The Court: All right.

The Witness: I don't think, your Honor, that they thought that there were many instances of the illustration that is suggested here.

The Court: Why, in the District of Columbia, I think every big corporation carries on business within and without the District.

The Witness: I mean exclusively here. One activity exclusive in one jurisdiction and the other activity exclusively in the other jurisdiction is what I meant.

In other words, you won't find many illustrations of an integrated environment that we enjoy in the United States where in one State the totality of manufacturing is confined and in another State the totality of sales is confined. That's why, it seems to me in a federal kind of jurisdiction where we have impurities deriving from the fact that autonomy exists in the States and autonomy exists in the localities to a considerable degree is the kind of taxes they use and the kind of criteria they use that this—

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[fol. 324] Washington, D. C.

Friday, August 25, 1961

The above-entitled matter came on for further hearing at 10:00 o'clock a. m.

Before: The Honorable Jo V. Morgan.

WALTER A. MORTON, was called as a witness for and on behalf of the petitioner, and being duly sworn by the Court assumed the witness stand, and, upon examination, testified as follows:

The Court: Professor, give your full name and residence to the reporter, please.

The Witness: Walter A. Morton, 108 North Spooner Street, Madison 5, Wisconsin.

Direct examination.

By Mr. Barnes:

Q. Professor Morton, what's your present occupation?

A. I am Professor of Economics at the University of Wisconsin.

Q. Will you describe briefly your prior employment, how long you have been at the University of Wisconsin and in what capacities, and other places.

[fol. 325] A. I have been at the University of Wisconsin snice 1925 continuously in various ranks. From time to time I have been engaged in other work and have taught at other institutions.

During the second semester of last year I was visiting professor on the Haines Foundation at Pomona College, Claremont, California.

I have also lectured in half a dozen or so midwestern universities.

I have also engaged in some consulting work with firms of various types—oil companies, public utilities, insurance companies.

Q. What has been the type of work in which you have been consulted by those companies, or the types?

A. In the insurance business I have been consulted relative to tax matters and relative to investments. In the public utility field I have been consulted with reference to rate of return problems and appearances before public service commissions and commissions of a regulatory nature in the City of Washington, D. C., that had Federal commissions.

* * * * * * *

Q. What is your educational background?

A. I received my Bachelor's and Master's degree at the University of Michigan. I then attended the Brookings Institution in Washington, D. C., on a fellowship and then later on came to the University of Wisconsin as an assistant instructor and took my Ph.D. degree there.

[fol. 326] Later on, I attended the University of Chicago and the London School of Economics.

Q. What was the principal field of scholarship in which you were engaged during these courses in school?

A. In general the field is economics with primary attention on the financial aspects. I teach money and banking, the credit system, financial history of the United States, and seminar in monetary and banking theory; I have also taught a course in the government regulation of business.

Q. Do you belong to any professional organizations or have you held offices in any of them?

A. I belong to the American Economic Association, the Midwest Economic Assocation, and I was president of the Midwest Economic Association in 1953.

Q. Have you published any books in the field of economics or articles in professional journals, and so forth?

A. I have published probably around 40 to 50 articles in various professional journals. I have published two books, one on housing taxation and one on British finance, 1930-1940.

Q. Were you present during the session in this trial yesterday?

[fol. 327] A. I was.

Q. Both sessions?

A. Yes, sir.

Q. Did you hear the hypothetical question which Mr. Wixon put to each of the three witnesses; he put it to two of them and then asked one to revert to it?

A. Yes, I heard it.

Q. Do you recall it?

A. I recall it.

Q. With Mr. Wixon's consent I am going to ask you to have that in mind without my reading it to you, but I will read it to you if he wishes.

Mr. Wixon: I take it you are using the same hypothetical question?

Mr. Barnes: The identical one you asked.

The Court: Are you satisfied, Mr. Wixon?

Mr. Wixon: Yes.

The Court: It is satisfactory to the Court.

By Mr. Barnes:

* * * * * * *

Q. Have you an opinion as to whether the application of the fraction described in that question to the total income of General Motors Corporation produced a reasonable approximation of the income fairly attributable to the District of Columbia in the two years involved?

A. Yes, I do.

Q. And what is that opinion?

[fol. 328] A. The opinion is that it does not produce such a result.

Q. I will, of course, ask you to explain your opinion, but before I do that I want to ask you to describe what is the result of applying this fraction, the numerator of which is District sales, the denominator of which is the total sales, to the total net income of the corporation?

A. The result is to ascribe all of the income arising from the business involved in the sales to the District of Columbia to the District of Columbia. That is, it ascribes 100 per cent of the income arising through all of the processes that produce the sales to the District of Columbia.

Q. Let me ask you to explain why you feel that the application of the fraction to determine the income attributable to the District is not a reasonable approximation?

A. Well, in the hypothetical question it is stated as a fact that there are no manufacturing facilities in the District of Columbia, and I know that manufacturing facilities and the labor which is employed in such manufacturing facilities produce some of the income attributable to the vehicles that are sold in the District of Columbia, and since this formula gives no weight whatsoever to the manufacturing facilities or to the labor, it is necessarily improper.

[fol. 329] Q. Professor Morton, you heard all the testimony yesterday?

A. Yes, sir.

Q. On page 402 of the transcript it reports that Dean Baily said, "It is the sales that create the income." Without attempting to paraphrase the rest of his testimony which was hung upon that peg I will ask you to say whether you agree with that statement?

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The Witness: I do not agree with Dean Baily's view as expressed in this testimony that income is created by sales. I regard that view as completely erroneous.

* * * * * * *

By Mr. Barnes:

Q. Will you explain why you take a different view?

A. I take the different view because in the practice of economics and in the history of economic thought there is no basis for the view that income is created by sales. It is always attributed to the factors of production which create the product of which all of the income is a result. The net income of a corporation is derived from the total value of the output of that corporation and that is net income is created by the traditional factors of production, which we call land, labor, capital and enterprise; and it is the input or the use or the activity represented by these factors which create all of the income of the corporation.

[fol. 330] Q. Professor Morton, is there any distinction in your opinion as an economist between the factors of production which you have just named and the factors entering into the creation of net income?

A. No, these are one and the same thing. The factors of production are general terms used to indicate all of the factors entering into the creation of income which might be detailed into 10 or 100 or 500 categories, but they all basically fall under the classification of factors of production and they include, of course, everything and every activity that a corporation engages in which is responsible for producing and selling the goods of which it derives its income.

Q. Professor Morton, on page 452 of the transcript there is some material which follows things that have been said before, that was from the testimony of Professor Watson. In the middle of the page he says:

"It cannot be said that one is more important than the other"—

Mr. Wixon: Excuse me, sir, if we are going to use this I want the record to show the questions and answers completely.

* * * * * * *

By Mr. Barnes:

Q. We will try this question.

"By Mr. Wixon:

"Q. Now, can it be said that one or the other of these two items is the more important cause of net income—sales or costs?"

* * * * * * *

[fol. 331] By Mr. Barnes:

"A. No, it cannot be said that one is more important than the other. The three, sales, costs and net income, are mutually determined. The famous figure of speech known to all economists is this, it is idle to debate whether it is the upper or the lower blade of a pair of scissors that cuts the paper, both cut it together, both sales and costs determine net income.

"Q. Now, sir, if you measured net income by costs what type of a result would you be likely to obtain?

"A. With the proportionality thesis to which I hold you would get exactly the same type of result.

"Q. And that is true, is it, sir, in respect of sales?

"A. Yes, the same result as would be given by the use of sales."

Now, Professor Morton, my question to you has to do solely with the last part of that answer to the effect that if income is divided in accordance with the sales factor alone or on the other hand, income is divided in accordance with costs, the result will be exactly the same.

Will you comment on that?

A. The result will not be exactly the same in my opinion. In fact, it may vary very widely. For example, in the simple situation in which a product is produced in one state and sold in another state the sales formula would attribute 100 per cent of the income to the state in which the product [fol. 332] is sold.

* * * * * * *

The Witness: I believe I mentioned that if the goods were sold in one state the sales factor would attribute 100 per cent of the net income to the state in which the sale occurred and give no weight whatsoever to the cost factors incurred in other states; therefore, you will get a different result if you use the sales factor than if you use cost factors.

The Court: Taking the situation that you have told us, suppose they use the cost factor alone?

The Witness: If the cost factor alone were used than all of the net income would be attributable to the states in which the costs were incurred.

The Court: Would you consider that equally vicious or bad?

The Witness: I would not consider it bad and vicious, although I would hold to the view that it is not improper for reasons which I could explain to give some weight to the sales factor.

The Court: All right.

By Mr. Barnes:

Q. May I ask, Professor Morton, in answering that were you assuming there were no costs whatever in the area in which the sales were effected?

A. That's what I was assuming in this illustration.

Q. On page 381, Professor Morton, we have this exchange:

[fol. 333] "Q. Dean Baily, as a matter of pure economic theory, would the use of a formula based upon property and payrolls produce a more reasonable approximation of the net income of General Motors fairly attributable to its trade or business within the District than the use of sales alone, in your view?

"A. I don't think so, because sales, the sales figure includes the expenses of production; it includes, then, the contribution of labor and capital to the production of goods."

* * * * * * *

By Mr. Barnes:

"The only way a company can make income is either by sales or investments; if it makes it through sales it vests in the costs the factors of production to be able to have the goods to sell.

"Therefore, the selling price, if the company is in business successfully in making a profit, the selling price provides a return for the expenses as well as the profit."

Now, Professor Morton, I want to go back to this part of the answer:

"The sales figure includes the expenses of production. It includes, then, the contribution of labor and capital to the production of goods," and ask you to comment on that.

* * * * * * *

[fol. 334] The Witness: It is true that the sales figure does include expenses of production; however, it does not follow from that fact that a method of allocation or appor-

tionment which is based upon sales alone takes into account the labor and capital factors. It does not do so.

* * * * * * *

By Mr. Barnes:

Q. Let me leave off the adjective and simply let me ask Professor Morton if he can think of any instances in which there is income completely disassociated from any transaction of sale?

A. Yes, sir. For example, in my part of the country farmers often consume part of their own produce, that consumption is part of their income; or we have a lot of do it yourself programs where men work at home and improve their own house; that's a part of their income. Or in more primitive communities where there was no exchange people produced their own sustenance and raised their own wool and wove their own cloth. This was income without a sale.

* * * * * * *

Q. Professor Morton, can you define for us what your understanding is of net income?

A. Net income consists of the total value of all of the goods or services produced minus the cost of production, sometimes net income is stated before Federal income taxes and sometimes it is stated after Federal income taxes. In these proceedings—

[fol. 335] The Court: Don't the goods have to be sold before you have a gross income?

The Witness: For tax purposes generally the goods must be sold, but from the viewpoint of economic analysis income is produced even before the goods are sold.

The Court: You mean gross income?

The Witness: Gross income.

By Mr. Barnes:

Q. And net income, too?

A. And net income could also be produced before the goods are sold.

Q. Now, does the net income change—

The Court: You mean from the economic standpoint?

The Witness: Yes, supposing a man builds a house, for example, which he knows has a market value of $30,000. It costs him $25,000 to build that house. He would say from an economic point of view, I have made $5,000 for myself, I haven't sold the house yet—

The Court: You don't have any net income for tax purposes until you shake the fruit from the tree.

The Witness: That is correct, so that I distinguish between net income for tax purposes and how a person would look at it from the viewpoint of economic analysis.

[fol. 336] By Mr. Barnes:

Q. Now, Professor Morton, having found the net income in the manner in which you have described is the net income changed by the effecting of a sale?

A. No, it is not. It is realized through the effecting of a sale.

The Court: You have the severance theory as far as taxes are concerned? It has to be severed?

The Witness: I think that would be one way of stating it.

The Court: In other words, a man has to sell the house before he realizes the income?

The Witness: That's correct.

The Court: But your theory is that he does enjoy the income before that?

The Witness: Yes, I'm not sure in every case for tax purposes there must be the severance. I believe there are some industries in which it is computed the other way, but I wouldn't be able to discuss that.

The Court: I understand that.

By Mr. Barnes:

Q. Professor Morton, what is your understanding of the meaning of the phrase "fairly attributable" in the District of Columbia statute which directs that that portion of net income which is fairly attributable to business carried on or engaged in within the District shall be assigned to the [fol. 337] District for tax purposes?

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The Witness: By fairly attributable I understand that to mean approximately attributable or reasonably attributable in the sense that it is caused by, created by, arises from, results from, due to, because of, or any other phrase which indicates an in fact relationship between income and the sales, or if I say it's fairly attributable to labor or to capital I mean is there an in fact relationship between the two. I do not take the phrase to mean that it must be measured with ultimate precision but in a general and approximate manner.

By Mr. Barnes:

Q. Are there reasonable means available for measuring where income is earned?

A. Yes, sir.

Q. And how would you proceed to do that?

The Witness: Limiting it now to a manufacturing corporation I would say that income is earned in the place where the manufacturing, administrative, selling activity is carried on; or in more technical language, where the factors of production are used to produce the income or where there are inputs of factors of production as measured by the costs that are incurred for labor and for capital in producing and selling the goods and services of the corporation.

[fol. 338] Now, if we find the place where these inputs are being used we can allocate the income to that place.

By Mr. Barnes:

Q. You described the factors of production in general terms some time ago, I believe, it was land, labor, capital, and entrepreneurial effort. Specifically what are the factors of production in a manufacturing corporation?

A. Well, first, we will take the general management of the company and let's say the planning or engineering department and the production department and the transportation department, and sales department, and there could be many other classifications in individual companies. Perhaps the financial department and a legal department, and many other activities of the company.

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By Mr. Barnes:

Q. I want to return, Professor Morton, to page 452 and the question:

"Now, can it be said that one or the other of these two items is the more important cause of net incomes, sales or costs?"

And the answer:

"No, it cannot be said that one is more important than the other."

[fol. 339] That, you will recall, was in the examination of Professor Watson.

And continuing—I apologize, I wish to strike that question and start all over with this one.

"Well, sir, to sum to a degree, do you have an opinion as to whether the formula that I have stated to you in this question of sales is consistent with accepted economic principles?"

There is considerable intervening discussion which is not on the point, but the final answer to the question is:

"My answer is, yes."

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Q. Will you state your opinion with respect to the opinion I have just read to you?

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The Witness: My opinion is that the single sales factor is not consistent with accepted economic principles because accepted economic principles from Adam Smith to the present day say that income and net income is related to the factors of production, land, labor, and capital, and enterprise, whereas the single sales factor gives no weight whatsoever to any of these factors. Therefore, I do not find in [fol. 340] the history of economics taught or in the present teaching of economics any justification whatsoever for the view that income is created by the sale.

By Mr. Barnes:

Q. Professor Morton, can you name any well-known authorities who have writings from which the answer you have given might be concluded?

Mr. Wixon: I object.

The Court: Why?

Mr. Wixon: I don't have those writings here, therefore, if they are going to be used in the case they ought to be produced for examination, your Honor.

Mr. Barnes: Just the names of authorities is all.

The Court: That's all right. I will overrule the objection.

The Witness: Well, this was the view of Adam Smith—

Mr. Wixon: Please, sir, I want an identification, Adam Smith, the volumes he has published, the publisher, and the dates.

The Court: Mr. Wixon, Adam Smith has been dead, I guess two or three hundred years.

Mr. Wixon: I didn't know him personally, sir.

The Court: I didn't either, but I have known his work, and he was supposed to be the father or grandfather or something of economics.

[fol. 341] Mr. Barnes: I am going to ask Professor Morton to give us the names of some outstanding economic authorities who in his opinion support the opinion he just now gave, and they are easily checked in any library.

Mr. Wixon: I object, I object on fairly obvious grounds. He is bringing in other people by statements, your Honor, who are not here in this courtroom, and says that they support his views. How do I cross-examine them, Sir? How do I ask them whether they support his views?

The Court: You certainly can do it in your brief.

Mr. Wixon: Your Honor, I am not required to do that. I am supposed to have available to me for cross-examination any witness who is going to testify or make a statement. Now, is your Honor going to read the books? I mean, I'm putting a question necessarily to make a point—read the books, determine that Professor Morton's statement is supported and therefore use the statement of the person whom he identifies as evidence in this case?

Mr. Barnes: We are talking here not about witnesses, your Honor, but authorities, which is another matter altogether.

The Court: I will overrule your objection.

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[fol. 342] The Court: We will get that in if it comes to that. All I'm ruling on now is that this is in response or rebuttal of your testimony that this theory is accepted economic principles.

I think you can testify, but give the names of them.

The Witness: Adam Smith, "The Wealth of Nations," first published in 1776; David Ricardo, "Principles of Political Economy and Taxation," published in a number of editions but I believe first in 1818; John Stuart Mills, "Political Economy," I believe is the name of his book. I may not recollect the names. "Principles of Political Economy," I believe the first edition was 1844. These men are known as the classical economists together with some minor economists.

Then one of the great neoclassical economists was Alfred Marshall, I read the book and had it in my hand just this morning—"Principles of Economics," I believe is the title, first published about 1890. Then among the latest books, I examined the one in which Mr. Watson was co-author, which I think was a good book and he supports my point of view in that book. There are three authors.

The Court: What is the name of it?

The Witness: I had that book in my brief case.

Mr. Barnes: Is this the one to which you refer?

The Witness: Yes. "Modern Economics," by Burns, Neal and Watson—the Watson being the Professor D. S. [fol. 343] Watson who testified here yesterday.

By Mr. Barnes:

Q. Professor Morton, do you know of any recognized economists who support the opinion to which we referred?

Mr. Wixon: I object.

The Court: Now, that sort of slurs a little bit the witnesses who testified yesterday, doesn't it?

Mr. Barnes: Well, we can modify the question, if we leave out the word "recognized," would that help? The witness testified that this was—

The Court: He would have to say, Yes, he knows, he heard three yesterday.

The Witness: That would be my answer, sir.

The Court: There were three yesterday that said that that was the right way to do it.

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By Mr. Barnes:

Q. On page 471 of yesterday's transcript and the testimony of Professor Watson, we find this colloquy:

"The Court: He is talking about activities of the corporation and he says these various activities—engineering, manufacturing, selling, all of those activities—they are called activities. I think the witness understands it, don't you?

[fol. 344] "The Witness: Yes.

"By Mr. McGratty:

"Q. And in your opinion do all of these activities taken in combination account for 100 per cent of the net profit or net income in respect of the cars sold in the district?

"A. To the question as stated my answer is, no.

"Q. In your opinion, is some portion of the net profit attributable to some other activity?

"A. Yes, the activity of the people who buy the products of the company. They, namely sales, and costs together mutually determine the net income of the corporation."

Professor Morton, will you comment on the statement that "the activity of the people who buy the products of the company are a factor" in addition to engineering, manufacturing, selling, etc., in contributing to the income of the corporation?

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The Witness: Well, I agree that there must be sales, like there must be production. It has been mentioned yesterday there must be weather, and I suppose there must be air, there must be a million and one other things that make possible human life and buying and selling, but for purposes of economic analysis we attribute the income to the activities which produce that income as measured by the [fol. 345] costs incurred and if we do as is commonly done in all analysis, including the analysis of national income by the United States Department of Commerce, exhausts the total income through the payments to the factors of production it would duplicate that income if we were to attribute an equal amount to sales. That is, if a corporation produces 100 million dollars of income and we attribute that income both to the factors of production and to sales, we would come up with a result of $200,000,000.

* * * * * * * *

The Witness: Well, aside from this book, I will say that to my knowledge all responsible computations of national income, whether by the Department of Commerce or by the National Bureau of Economic Research, or any other responsible agency, makes no allowance whatsoever for sales in itself as a creator of income; it deals with income as arising through the input of factors of production in various classifications.

By Mr. Barnes:

Q. Professor Morton, here is a quotation that is so similar to others that I have presented to you, at least I think it is, that I don't want to waste much time on it. Let me ask you quickly to comment on this. It's on page 478 in Professor Watson's testimony.

"The Court: Don't I understand your testimony to be that if the entire product of General Motors were sold to customers in the District of Columbia that the entire net income of this corporation was earned in the District of Columbia?

[fol. 346] "The Witness: Yes, I so testified."

Will you comment briefly on that one.

Mr. Wixon: I object. What is the comment going to do, your Honor? I have never heard of a cross-examination where a witness is asked to make a statement concerning the testimony of another witness. I had thought it was Hornbook that that was not permissible.

The Court: I will overrule your objection.

The Witness: First, I agree with the witness that his theory is consistent with this result, that if the sales factor alone is used then he would be obliged to attribute all of the income from sales in the District of Columbia to the District of Columbia.

Now, I do not agree that that is a proper method of apportionment because it neglects other factors that are responsible for the creation of that income and for which the company incurs costs.

Now, such factors have in practice—

Mr. Wixon: I object, excuse me, sir. This is far beyond this statement here, sir—far beyond it. Look what your Honor put to the witness, a question as to what his testimony was to be taken as meaning. You stated it, he said he agreed that that was it. That's all there was here, sir.

[fol. 347]

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By Mr. Barnes:

Q. Page 510 in Mr. Nathan's testimony, we have this colloquy.

"By Mr. McGratty:

"Q. Mr. Nathan, do I understand correctly that it is your opinion that the net income or net profit of a corporation is derived from a number of different factors?

"A. A wide variety of factors, yes, sir.

"Q. And would those factors include all of the engineering, manufacturing, administrative, selling and other activities of the corporation?

"A. Everything the corporation engaged in can affect and does affect, may effect the profits of the company, the net income, yes.

"Q. And do all of those factors which I have mentioned contribute in some measure to the net income of the corporation?

"A. Yes, and no. They may contribute to losses, or they may contribute to profits, and there is no way in my judgment of saying that any specific factor has contributed any specific proportion to the net income."

On page 512:

"Q. But the net income, in your opinion, is attributable to a greater or lesser extent to each of these factors?

"A. Some positive and some negative; yes.

[fol. 348] "Q. Is it possible to measure in any way the extent of the contribution to net income by the various activities carried on by the corporation?

"A. In my judgment it is not. It is not conceptually nor practically."

Now, Professor Morton, in your opinion is it not conceptually possible to measure the extent of the contribution to net income of the various activities of the corporation?

Mr. Wixon: I object.

The Court: I overrule the objection.

You mean of a corporation of this type?

Mr. Barnes: Yes, we were talking here about General Motors.

The Witness: It is conceptually possible; indeed, it is conceptually necessary from the viewpoint of a rational economy or from the viewpoint of an individual corporation to have some conception of whether or not a given output or cost or expenditure contributes to the net income. That is one of the purposes of cost accounting which aids the management in making such decisions and to say that it is conceptually impossible to allocate any income to any cost means that rational management is impossible.

Now, I don't believe that management is perfect, or that they have perfect foresight, or that they are omniscient, but there is some rational relationship between the costs that they incur and the income that they produce.

[fol. 349] By Mr. Barnes:

Q. That's a conceptual matter.

Now, as a practical matter and by practical matter I assume we are talking about practical for tax purposes, as a practical matter can a reasonable measurement of the income attributable to these factors be made?

A. Yes. I think it can be made. For example, it is reasonable to say that if a plant is located in the State of Michigan, that the operations of that plant make some contribution to the income of the corporation which owns that plant in the State of Michigan and if they have branches in other states I think it is conceptually, as well as practically, possible to apportion some of the income produced by that corporation to the operations of those plants in the various states.

Q. Do you want to suggest tests which might be applied to effect that measure?

A. Well, in practically—the test is, of course, the amount of property located in a given jurisdiction or the amount of payroll in a given jurisdiction. These are rough indicators, though not precise measures, of the importance of the labor and capital factors. But to say that it's conceptually impossible to allocate income to any particular factors of [fol. 350] production, I think, is basically erroneous.

Q. Do you think—would putting those two factors in combination be a reasonable approximation?

A. I think they would give a practical result.

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Mr. Barnes: The question I should have asked him, then, was is there a reasonable measure by which the income, having been divided up departmentally, can be divided up geographically, and that was the error of my examination.

The Court: You mean net income?

Mr. Barnes: Net income.

Can you direct your answer to that one, Professor Morton?

The Witness: Yes. If we determine the factors responsible for net income within the operations of the corporations we can divide them up geographically by ascertaining

where those factors are operated, that is where the plants exist and where the labor is employed.

The Court: What about where the sales take place?

The Witness: If there is an expense incurred where the sales take place then, of course, the expense factor in that area would have to be taken into account.

The Court: You mean it is determined by the expense?

The Witness: What I am suggesting is this. If one were [fol. 351] to allocate geographical location of costs—

The Court: We are not talking about costs, we are talking about net income.

The Witness: Yes, if we were to determine the creation of net income by the geographical allocation of costs, then, as in the case of manufacturing we would be obliged to say that where the plant is and where the labor is incurred there the income is being created.

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By Mr. Barnes:

Q. It would be fine except I had to backtrack because of my error in leaving out the reference to geography.

You have said in the last minute if I may repeat it to make sure that I understand it correctly, that you can allocate or you can divide the income up geographically by reference to the costs incurred in the various areas in the production of the income.

A. That is my testimony.

Q. Very well.

Now, I want to go on from that because that's a pretty complicated thing, perhaps, to do and get to the practicalities of the tax problem which is to find some easy way of doing this, and ask you again whether you can suggest some fractions or factors or some process for making a reasonable approximation of that division of costs?

[fol. 352] A. I agree with the common practice of using a formula which gives weight to payroll and to property in the various jurisdictions.

The Court: You don't agree with the uniform factor?

The Witness: I think that uniform factor is all right.

The Court: The uniform formula?

The Witness: Yes, I do.

The Court: That has the sales factor.

The Witness: I know, but I was responding only directly to his question here as to method of allocating the costs.

The Court: Oh, I see.

The Witness: Yes.

By Mr. Barnes:

Q. Now, Professor Morton, in your opinion can you suggest what you think is the best, the most reasonable of these various approximations for arriving at the income that is attributable to this or that area?

Mr. Wixon: I object, your Honor.

The Court: Let's take a concrete case here that we have. Let's take General Motors in the District of Columbia. You have all the facts before him.

Mr. Barnes: We have all the facts in the hypothetical question as presented yesterday and as presented this morning to Professor Morton; we don't have arithmetic but [fol. 353] we don't need arithmetic, I think he can answer on principle.

The Court: All right.

By Mr. Barnes:

Q. These facts as you recall are that General Motors Corporation does all of its manufacturing outside of the District, and it makes sales within the District and it has employees who are engaged in that activity, and so on, in the District.

The Court: And bear in mind that we are talking about the segment of the activities of the corporation that comprise the manufacture of X number of products and their sale in the District of Columbia, not necessarily in the District of Columbia but sale to customers in the District of Columbia.

By Mr. Barnes:

Q. Now, under those circumstances, can you suggest a practical approach to determining the portion of General Motors Corporation's net income which is fairly attributable to the business carried on in the District?

A. I believe that either a two factor formula using property, payroll, or a three factor formula, would produce a fair and reasonable result. But I do not believe that any formula which uses only one of these factors, whether it be payroll alone or property alone, or sales alone, is proper. [fol. 354] Now, I do not hold to the view that a three factor formula is permissible because I regard sales as a creator of income, but because sales may be a measure of some of the advertising and sales costs which may not be properly allocable to a given jurisdiction and therefore may be divided over the total sales of the company and then allocated back to the various jurisdiction in proportion to the amount of sales incurred, sales made.

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By Mr. Barnes:

Q. What kind of sales are you talking about; sales to the location of the customer, sales through an office, sales from inventory, sales where?

A. Sales in a given destination.

Q. Destination?

A. Yes.

Q. Very well.

Now, will you restate, just to clarify the record, the reason for your suggestion that a property factor is a good factor to use?

A. Because the property factor is a rough approximation of the capital and land and enterprise costs incurred in a given area. It also indicates, since property is used along with labor, that there is a great deal of labor activity in a manufacturing corporation where the property exists. [fol. 355] Q. Now, will you explain also, again, why you suggest payroll as a factor properly to be considered?

A. Well, payroll is obviously a measure of the input of the labor factor.

Q. And now will you explain why you suggest that the sales factor may in cases be added?

A. I suggest the sales factor may be added because there are certain inputs or costs which are not easily and readily and obviously allocated to a given jurisdiction where incurred and may be reasonably allocated to the place where they take effect.

Q. What is the nature of such costs?

A. Well, advertising costs in national magazines, for example, and other general sales costs which are the result of programs that are nationwide.

Q. That is the entire reason for the suggestion of the sales factor?

A. Well, if there were any other costs that would fall under the same—

Q. You have mentioned costs, yes, but I meant aside from allocating certain costs, is there any other reason for the sales factor?

A. No.

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[fol. 356] Cross examination.

By Mr. Wixon:

Q. I take it, Professor Morton, that you are not particularly impressed with the addition of sales as a factor to the two factors that you mentioned of payroll and property?

A. I don't know what you mean by being impressed; I said it's agreeable to me to do it because it is a way of taking into account these cost factors that may not be otherwise allocable.

Q. But it's only for that reason that you would add sales?

The Court: That's what he said.

By Mr. Wixon:

Q. Only for that reason?

A. That's correct.

Q. And you mentioned costs as perhaps being included in the sales factor. You mentioned advertising costs on a

national basis, promotional costs and any other cost, I think, although not necessarily particularly described by you might be included?

A. I don't say that they are included in the sales factor, I say that it is one way of proportioning these costs by use of the sales factor. As we assume these costs are incurred where they take effect.

Q. Let me ask you, sir, now, you had used sales, I take it you mean the gross sales figure, by that let me—

[fol. 357] A. I mean whatever figure is used in the law here for the purpose of sales.

Q. Let me put it this way, sir, we will have a clearer understanding of it.

If General Motors sells for $500,000 cash automobiles to customers in the District of Columbia, the number is immaterial, you are using that gross figure of $500,000 as the sales in your sale portion of the formula; is that correct, sir?

A. Roughly, yes; if one allows for returns and matters of that kind.

Q. Yes. Assume the sales are consummated, there are no returns, but it would be the $500,000 gross sales price?

A. That's what I have in mind.

Q. Now, doesn't that gross sales price of $500,000 include, if we are not assuming a loss operation, including all the costs attributable to or incurred in the production of all those automobiles which were sold for $500,000? A. Yes.

Q. And doesn't it rather overemphasize the matter to add to that payrolls, which are another cost and which theoretically are included in the sales?

A. No, it does not.

Q. I see. Why not?

A. For the reasons I have just explained, because there [fol. 358] is no emphasis whatever upon costs in using a single sales factor simply because the sales figure includes cost. It is a complete non sequitur, I would say, to make that type of inference.

Q. I see.

Well, now, property doesn't include cost, does it?

A. Property is not a cost but it is an indicator that some costs have been incurred. I agree with you that property itself is not a cost factor.

Q. The mere fact that it's an indicator that some costs have been incurred doesn't give it any particular significance if you know the costs themselves, does it?

A. It is a rough measure or as I prefer to say indicator. Now, if there were some feasible way of using the costs themselves, some way which I do not know of, I presume on theoretical grounds I would have to endorse such a method.

Q. Now, sir, you said some costs were incurred and that property is an indicator of the fact that some costs were incurred, but what is the relevance between property as a mere rough indicator of some costs? What rationale gets you to what costs or how must cost, when you use some costs?

[fol. 359] A. Well, in this way: property is an indicator of costs being incurred. If a corporation has actively in use property of $100,000,000 in a given area there are automatically certain charges or costs that go along with such property, namely, depreciation, maintenance, repairs, the interest costs, and whatever enterprise cost is allocable to such property.

Q. Suppose we had in the State of Michigan, if I may assume these facts, a corporation known as the General Motors Corporation; its total number of plants each identical in size in the State of Michigan was 20, and 15 of these plants are idle, they are stand-by plants, they don't use them, but they use 5 of those plants. Now, on what basis would you include those 15 idle plants as part of the property?

A. I didn't say that I would include them.

Q. Well, suppose they were operating at 10 per cent of capacity, what would you do then, sir, in respect to those properties?

A. I think I would do it the way it's being done, wherever the property factor is being used.

Q. You didn't identify, I think, sir, what you would include in property. What would you include in property?

A. No, I haven't identified what I would include in property.

Q. Would you do that, sir, now?

A. Well, I believe that what we would include in prop-
[fol. 360] erty would be the physical property of the corporation which can be identified—real and personal physical property.

Q. All the properties owned by the corporation, in other words?

A. Real and personal.

Q. All the properties real and personal?

A. Physical, or tangible.

Q. So, as a matter of fact, you would have to include in your property factor properties of the type that I just described, plants which were not being used, isn't that true, sir?

A. Well, if there were circumstances in which those properties were not being used and it were demonstrated that they are not properly a part of the income-producing assets of the corporation that fact would have to be taken into account by a tax administrator and is not a matter of general theory.

Q. But property—

The Court: Would it be included in the property factor? Property not used by the corporation in manufacture, generally speaking?

The Witness: If it were generally used, in my opinion it should be included because it's not practicable to make an ascertainment of the degree of use—

[fol. 361] The Court: No, I mean take an idle plant, no use at all.

The Witness: Well, I doubt whether such a plant should be included at all. If it were completely idle and not used, for example, I have been through the City of Detroit and I saw the old Hudson plant being torn down. Now, if that plant was technically being owned, if it were included, it would probably be included at a very low value which means that in effect the idleness produces a lower valuation for the plant, and this is what it usually does for taxation purposes.

By Mr. Wixon:

Q. No, sir; I'm not talking about it on taxation purposes, I'm talking about purposes of economics, that's what you were talking about here, sir.

A. I have not studied the question as to the degree to which the use of a plant should affect the valuation of that plant for the purposes of this tax formula. I haven't studied the degree to which it is feasible or practicable to take into account the varying degrees of use.

For example, a steel plant sometimes operates at 50 per cent of capacity, sometimes at 100 per cent of capacity. I do not believe it practicable for these purposes to vary the importance of the property formula in accordance with the rate of steel operations, for example, or in Minnesota, where the iron mines are sometimes down and hardly operating at all; I doubt whether it's feasible or practic- [fol. 362] able to take them out of the formula just because of that reason, then push them back into the formula the next year because they are operating at 100 per cent. But I have not made a complete study as to the feasibility of that because I'm not a tax administrator.

The Court: All right, you have it.

By Mr. Wixon:

Q. Let me ask you one more question, sir.

Now we will not use a manufacturing plant like this, we will use a lumber producing plant. This lumber company, if we may, in the State of Washington, owns 1 million acres of property, and progressivly it cuts trees on that property which it processes in one way or the other and finally sells, but at no time is all of the property on which the trees grow being used for the purpose of obtaining trees, and the percentages over that land where trees are cut vary.

Now, how much of the property of the million acres that I mentioned would you include in your property factor, sir?

A. Well, if the practice is uniform in the various jurisdictions it doesn't make a great deal of difference because

you are using a ratio but I haven't given any particular study as to how one would value the property of a lumber company in the State of Washington, but it really makes very little difference if all of the property is included or [fol. 363] not included so long as one follows the same practices because it would not alter greatly the ratios.

Q. Now let me ask you, Professor Morton, you will agree, will you not, that if only 5 percentum of those million acres that I mentioned to you are actually being used for the purpose of taking trees, that it does rather overweight the thing to put in the remaining 900 thousand acres as a property factor for purposes of taxation, let us say, as it relates to the State of Washington, because those 900 thousand acres, we assume, according to my example, did not produce any trees—it produced trees—in the sense it produced trees for sale, the acres remained idle.

A. Well, I don't know that I could agree that the only acres which produce trees are the acreages which are actually being cut at the moment.

Q. Well, there's no expense incurred in respect to those 900 thousand acres in my example, just property, sir, just property alone, standing property.

A. Well, there may not be any expense incurred in the idle acreage, although that's usually not the fact, but I'm merely assuming it because you state it as an assumption, not as a fact.

Q. Yes.

A. There usually is expense coincident with it. But since you use ratios of property in a given jurisdiction to the total property, if you used the same methods in all cases it doesn't make a great deal of difference how these problems are resolved.

[fol. 364] Q. You are speaking of it now on a national basis, I take it, that is to say if you apply this approach uniformly throughout the 50 states that it's rather immaterial insofar as the ultimate splitting up of income is concerned, I take it? That's your premise there?

A. Yes, that's true. That is if a uniform method of valuing this property is used it wouldn't make a great deal of difference.

Q. Now, all this property that I mentioned to you in the case of the lumber company is in the State of Wisconsin, and none of it is anywhere else, none of it is in Michigan, for example, but the lumber is sold by this company primarily to the State of Michigan, it's there that the market is, it's there where the customers are.

Now, under those circumstances I take it that in this multiple factor formula that you use insofar as property is concerned that factor would be entirely, 100 percent, in favor of the State of Wisconsin and none of it would, of course, be in the State of Michigan?

A. That is there would be no property in the Michigan computation?

Q. That's right.

A. All right.

Q. Now, for tax purposes that necessarily would result that insofar as property was concerned, property alone, that Wisconsin would be entitled to the entire tax.

A. Insofar as the property bore an element in the weighting in the formula; yes, sir.

[fol. 365] Q. And that would be true, would it not, even though all of the market for these products was in the State of Michigan, in my little example.

A. That is correct, insofar as the property factor alone is concerned.

Q. Now, you used payroll as another of your factors and I understood you to say that so far as you were concerned, individually, that preferentially you would stop with the use of the two factors of payroll and property. I said preferentially now, sir.

A. Well, I would prefer to say that it is a matter largely of indifference to me whether or not one uses the two or three factor formula because I believe that either the two or three factor formula will practically effect a reasonable proportioning of income.

Q. Why do you select payroll?

A. Because payroll is conventionally used in many areas and is an easily and readily ascertainable factor and because it measures in a rough way the input of labor.

Q. But there are other expenses involved in labor?

A. That's true.

Q. I think you—

A. There may be fringe benefits in labor.

Q. Would you weight these two factors? That is to say, would you give, say, payroll three times the weight that you would give property, or vice versa, or use some other weighting?

[fol. 366] A. I have not made a study of weighting of the matter.

Q. What would you do in the case of corporations where one of them, two corporations, one of them has extremely high payrolls, the other one has extremely low payrolls, but they produce identically the same product, and the margin of the profit is the same. Would you say that the payroll in the one case equated equally with the payroll of the other for the purposes of determining the production of income?

A. I think in the case you cited that where the payroll was a large proportion of the total expenses of the corporation it was more, the labor factor was more important than the other case; yes.

Q. Does expense create income?

A. The expense does not create the income, but the things for which the expense is incurred creates the income. Labor expense doesn't create income, but the workers on the assembly line create the automobile which creates the income. Expense is a measure of the workers effort.

Q. But we are not involved here, of course you understand, Professor, in trying to measure the activities of the workers; we are trying to measure the amount of the tax on net income.

The Court: All he said was—you asked him whether or not expense produced income; all he answered was, simply, no, the only thing is the expense paid for it.

[fol. 367] By Mr. Wixon:

Q. Does property standing alone create income?

A. Not standing alone, it has to be used by the management together with labor.

Q. You gave an example of a man who builds a house at a cost to him of $20,000, you may have used a different

figure but I think it's immaterial, and when he completes this house that house has a market value, let us say, of $30,000 and you stated as I recall your testimony that in such a case he has income of $10,000, the difference between the cost of $20,000 and the fair market value of $30,000—

The Court: But only economically.

By Mr. Wixon:

Q. The economic cost.

He has economic income does he not, sir?

A. That's correct.

Q. What is the economic income which you would determine and how would you determine it in the case of the production of automobiles where the costs were so much money, it's immaterial how much, and the value or the income from those automobiles was a figure unknown. How would you go about determining what it would be?

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[fol. 368] The Witness: The economic income would be the value of all of the automobiles produced minus the cost of producing all of these automobiles. That's the economic income.

The Court: You equated it with the house?

The Witness: That's right.

The Court: Yes.

By Mr. Wixon:

Q. Now, would you include in that property to get the economic income? Would you add property there? You said costs.

A. No.

The Court: Add property in something like that. All he said, Mr. Wixon, was you asked him what was the economic income. He said it was the difference between what the automobiles cost to manufacture and what they were worth.

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By Mr. Wixon:

Q. Now, if income is produced by those elements, if I correctly stated them, sir, if I didn't please tell me—land, labor, capital and enterprise—if income is the result of the application of those items don't you have income when you have applied all of these things? Don't you automatically have income?

[fol. 369] A. If you apply them intelligently to produce goods that have utility, but if you apply them unintelligently and indiscriminately you may not produce anything worthwhile.

Q. What is income, then, sir? How would you know whether a man had applied them properly to get income and not properly to get income?

The Court: He said income was the difference between what it cost to make the automobile and what it was worth when it was finished.

By Mr. Wixon:

Q. Wouldn't the sale of the vehicle or the item produced pretty well measure that income result?

A. It is a good way, probably one of the best, to measure the total value of the output. It's the one most commonly used.

Q. And every time you make a sale, Professor Morton, isn't inherent in the price of the product, if you are going to have any realistic income, reflected all of those items that you have talked about—land, labor, capital, enterprise?

A. Oh, yes, the costs incurred for the use of all of these items is in the selling price.

The Court: That's why he objects to this one factor formula. He says that's true, but you don't give any credit to the place where the expenses were incurred. That's where he said the objection was.

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[fol. 370] By Mr. Wixon:

Q. Tell me, I'm a little bothered by this inclusion of sales on the ground that some advertising costs may be included in that sales element which would otherwise be overlooked.

What significance do the advertising costs have?

A. Well, I use them as an example of costs which are not easily allocable to a given place.

Q. Suppose now there was a program of advertising but none of that advertising was directed to the place where the sales were made. How would you do something with that, sir?

A. I suppose that would be something difficult to do, but that is a highly unlikely situation for a concern of nation-wide importance. General Motors, when it advertises, say, a Chevrolet, I find them advertising in Life, and in the Saturday Evening Post, and national magazines.

Q. That's a tremendous organization, but you will have to agree there are a number of smaller organizations that don't have that national advertising approach. This approach you have would have to be applicable to everybody, would it not, sir?

A. Yes, sir. I had in mind, of course, General Motors when I was testifying. I haven't studied in detail how it would operate for smaller companies and my experience is that almost any formula that has a rational basis never-[fol. 371] theless may not operate with the same perfection in every situation. But it should still have a rational basis, that's my view.

Q. Income is not, according to my understanding of your testimony, created by a sale?

A. That's correct, sir.

Q. It is not created by a sale?

A. No, sir.

Q. Then, when you add sales the only reason you add it, if I may be clear upon the subject, is to get a reflection of expense?

A. That is correct, sir.

Q. Now, there are other ex[illegible]ses, of course, incurred in this process. You have general overhead, you may have litigation expenses—just exactly as General Motors is in-

curring right here. They are all expenses and they are all part of that whole picture. What would you do with those, sir, because sales wouldn't reflect that, would it?

A. Well, since you bring those up, the sales item would be a way of giving some recognition to these expenses over the general area in which the product is sold. Yes, it would.

Q. Then, sales would take in every other expense besides payrolls?

A. It is a way of giving recognition to those expenses that may not be directly allocable to a given jurisdiction for a nationwide corporation.

[fol. 372] Q. Now, if those expense items could be ascertained definitively, that is to say 100 thousand dollars expense definitely incurred in Michigan, 100 thousand dollars of expense in Wisconsin, and so on down the line, you would say then that there would be no point or necessity of including sales because you would have the definite determination of expense allocations; is that correct, sir?

A. That would be true. Then I would say that a two factor formula would be satisfactory.

Q. Professor, I am a little confused, and that may be an understatement, but I am a little confused about property and payroll and sales in respect of my understanding that income is produced only in the place where factors of production are used and that those factors are land, labor, capital, and enterprise.

Now, labor, I take it by that you mean the application to something of an individual's creative ability in one way or another; land you use in the sense of capital, I take it; all right there, sir?

A. Well, in the accounts of a corporation it would merely occur in the property accounts, or as capital; yes, sir.

Q. So we could, I think probably for our purposes, just drop the two—land and capital words—and use the one, capital, to include all physical assets of the corporation?

A. That would be satisfactory.

[fol. 373] Q. We have then, labor and capital and enterprise. By enterprise I take it you mean the fact that somebody goes out into the market and makes it possible by his salesmanship or some other means the movement of the goods which have been produced?

A. No. I mean not only the movement and the sales but the manufacture. The reason for including the item enterprise is to give some explanation of why profit exists in addition to pure interest and labor factors in income.

The Court: That's sort of administration, isn't it?

The Witness: Yes, and risk taking.

By Mr. Wixon:

Q. Measurable, sir, by anything at all particularly?

A. Well, it is measurable by corporate profits.

Q. But I mean measurable in a formula. Can you measure enterprise by a formula?

A. It is very difficult to measure in a formula, it is one of the most abstruse and difficult concepts in economy, and the Ricardo and Marxian theory neglects it altogether, they come to the conclusion there is only one factor of production—labor—and congealed labor as mentioned by Dean Baily and the private enterprise our capitalistic economics says there is some other factor there, namely, the enterprise or organizational factor or team factor or risk factor, or whatever it may be called, which persists and which [fol. 374] makes possible the growth of our economy.

Q. I gather you don't quite concur with Ricardo in that area?

A. I'm not a Marxian, sir, and Ricardo held to this congealed labor view of capital and it was taken up by Marx and used as the basis for Communism, and I don't endorse that point of view.

Q. Either as a matter of economics or otherwise?

A. That's right.

Q. Well, we have then, as I see it, ourselves down to two elements basically—capital and labor, since you do not agree with Ricardo on some of his approaches.

A. Capital, labor and enterprise—three.

Q. Well, shouldn't a formula include enterprise, then? You have to have it in there if income is produced by capital, labor and enterprise, the formula should reflect it, shouldn't it?

A. It should reflect it, and I believe where the capital and labor is, the enterprise will be there also. That is—

Q. But you realize, sir, that in any formula we use we have got to use dollar amounts, we can't just say capital, labor and enterprise, without putting something in the spot where enterprise is.

The Court: What about payroll?

The Witness: Well, payroll reflects the labor factor, and property reflects the capital factor and the two—

[fol. 375] The Court: Doesn't payroll reflect a good deal more than the labor factor?

The Witness: Yes, it reflects also the management of that labor factor, the use of that labor factor, the employment of it, the direction of it.

The Court: Isn't that enterprise?

The Witness: Yes.

The Court: Wouldn't payroll reflect enterprise?

The Witness: It does—both the property factor and the payroll factor reflect that there is some enterprise there, or there would be no property, there would be no payroll in our system.

Mr. Wixon:

Q. Well, you used the word "enterprise" before when Judge Morgan asked you some questions, in a formula or a statement that income is the result of labor, or payroll as we were using it, capital and enterprise—those three items.

A. Yes, sir.

Q. And I asked you simply whether since labor is already identified as payroll you can't identify it again as payroll, wouldn't it be absolutely essential, properly, to have some element for enterprise? You can't use payroll twice.

A. No, there is no element that I can conceive of which for the purposes of apportionment could be called enterprise. We must assume that the enterprise exists in the [fol. 376] use and direction of property and payroll.

Q. And thus you get to a two factor formula ultimately necessarily, don't you, because income then is from the formulary approach, measurable only by capital and labor?

A. Not measurable by, it is—

Q. Determinable by.

A. It is created by—no, capital, labor and enterprise.

Q. I said as a formulary approach, sir.

A. Well, I'm assuming this in the formula the capital and labor factor will show that there's also some enterprise.

The Court: You are using labor, but don't you think it would be clearer if we stick to the conventional term of payroll? Labor means to me that is the man who comes in and manufactures the automobile, and payroll covers not only that but all the others, for instance selling, enterprise and management, and administration, so forth, doesn't it?

The Witness: I agree with you, your Honor; it would be clearer if we stuck to the phrase "payroll," because that includes Mr. Donner, the Chairman of the corporation as well as the other, so that's what I really intended.

The Court: It also covers the selling force.

The Witness: Yes, sir.

The Court: It has nothing to do with the manufacturing. [fol. 377] The Witness: The actual direct labor force may be a smaller part of the total in some industries.

By Mr. Wixon:

Q. Suppose you had a large payroll in one place, we will call it a payroll of $1 million, and a payroll of half of it $500 thousand in another place, and the people in the place where the payroll was $1 million were rather shiftless, but the people in the place where the payroll was $500 thousand were to the contrary, very intelligent, hard working, skillful; and the people in the place where the payroll was $1 million caused the company severe losses, but the people where there was $500 thousand of payroll managed to overcome that. How would you take those factors into account, sir; or would you?

A. In this apportionment formula they would not be taken into account.

The Court: You ought to read the Butler case in California, that's what happened there. They said the three factor formula was to be used although they had an actual

loss in California and they said, well, you can't do that, we want a separate accounting, this factor wouldn't work, the Supreme Court said, you are wrong, it does work, just because you lost money in California you can't tell what that operation in California might have contributed to other places. That is the Butler case, it really is very interesting. Butler Brothers v. McColgan or McColgan v. Butler.

[fol. 378] The Witness: I believe I have answered it, I said that in this apportionment formula no distinction would be made between operations in various jurisdictions whether those particular operations operated at a loss or profit. We assume that the net earnings or the profit of the corporation is being allocated in proportion to these factors, without regard to the fact whether in a particular operation or area there is a profit or loss.

By Mr. Wixon:

Q. Now, Professor, you, of course, are aware that this is a tax upon dollars that we are talking about?

A. That's right.

Q. And the tax upon dollars, since you have familiarized yourself with the understanding of this material—

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Mr. Wixon: You understand, sir, when we talk in this taxing area here we are talking about income in the dollar sense, not income in the fair market value sense. You realize that, sir?

The Witness: That's correct, but there's no distinction between the two because fair market value is also measured in terms of dollars.

* * * * * * *

Q. In other words, sir, we are talking about for tax purposes here income in the sense of the difference between the price for which something is sold and without trying to be definitive, the expenses which were related to the item which was sold?

[fol. 379] A. Well, that is one type of net income, but there are the other types that I have mentioned.

Q. We are directing ourselves here in this case to that proposition.

A. Well, that I can't testify to, as to what is the complete nature of this case.

Q. No, I didn't meant that, I meant that we are talking about dollars in the true sense, in the real sense, that is to say a number of dollars over and above the costs which were incurred in producing the product which was sold for those dollars.

A. Well, my only difficulty is with accepting the view that we are always referring to the product which has actually been sold because in some cases it may not have been sold.

Q. You will agree, sir, that it would be impossible, as an individual you know that it would be impossible for us to tax something which was just in the warehouse, not moved out into the open market, for a price over and above what it cost to make, or would you say, sir, to the contrary that there should be a tax levied on that income?

A. I haven't studied the matter as to whether or not there should be a tax levied on that income under all circumstances or whether there should not. I know that income is accrued differently in different enterprises and I simply will have to say that I don't know what the practice should be. That is a matter for tax administration. There may be a mining company, for example, that follows [fol. 380] a different practice, and I am not now prepared to say whether they should be taxed in proportion to their net income in precisely the same way as a bank, let's say, or a manufacturing company. That I am not prepared to say; I will simply have to answer I don't know.

Q. As a matter of economics, the income would be earned when the product had been completed and had a fair market price over and above its cost?

A. That is right.

Q. Now, if you will direct yourself, please, sir, to the proposition I have in mind, the real one that we are faced with here, dollars.

Would you say, sir, that no income was produced whatsoever by the sale of the item for a price which was greater than the cost either of making the article or acquiring it?

A. My answer to that would be as follows: that if one computes total costs to include all factors of production plus enterprise profit then nothing can be attributed to sales as such because all of these factors combined will equal 100 per cent of the selling price.

If one includes some proportion of the selling price as being due to or created by the sale then one must decrease the amount due to the other factors of production. It is common practice to attribute all of the income to the other factors of production, including enterprise, profit and none to sales, and this practice is followed in the [fol. 381] national income accounting and in all economic analyses that I am familiar with.

Q. Well, you will agree, will you not, sir, that economic studies and analyses are directed almost, well, I was going to use the word without exception—I don't know enough about it, but I would say almost without exception to the fact of the market, the effect of world conditions on the market, the effect of other economic conditions upon the availability of a customer for the sale of your products?

A. Oh, those are very important things.

Q. Well, why should they be, sir? They are not affected in the economic end of the things as you have expressed it except by the application of labor and capital?

A. Well, if there is no market it means that in some areas either that you're producing the wrong type of product, then you should not devote your labor and capital to that production or it means that in some other area of the world in which you expect it to sell they are not producing anything and therefore have no purchasing power.

Q. Why is it necessary to have a customer, sir? You have your income from the economic standpoint when you have applied two elements—labor and capital?

A. The reason you must have a customer is that in an exchange economy you produce for exchange, you produce value to exchange with another person who has produced value, and if no such person exists then you cannot exchange [fol. 382] but would have to go back to an area of non-specialized production, or of a household economy. That is the reason.

Q. But I have trouble there, sir, because the man who produces grain and eats it himself has income. He doesn't have any customers at all, and as a matter of economics you state he has income.

A. That is true, but the farmer in North Dakota would have a hard time eating all of his wheat himself, so he produces for a market, but he can sell it in that market only if the other people in the country have produced something to exchange with him.

Q. So that the market is of extreme importance in this economy, is it not, sir?

A. Oh, I agree to that. The market is of extreme importance.

But one duplicates the counting of income, if one adds the income accruing to the factors of production to some I'd say mythical or mystical sales factor which I have never been able to fully understand.

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By Mr. Wixon:

Q. Let me ask you, sir, when you take labor and capital and you put them together, aren't you in fact combining two elements or two assets into some other asset? Isn't it at that point simply an exchange of one asset for another?

Let me give you an example, sir.

[fol. 383] . You take $100,000 out of the bank and you buy $100,000 worth of lumber, and you go out in the open market and you get 1,000 people and it costs you $100,000 and you pay those people $100,000, and you have your $100,000 worth of lumber and they bang away at it and hammer away at it and combine it and finally you have, instead of $100,000 worth of just raw lumber, you have a certain number of tables and chairs.

Now, you put $100,000 in your lumber, you put $100,000 in paying people, so your $200,000 is out of the bank and in exchange for it at that juncture, forgetting the market, have $200,000 worth of tables and chairs.

Isn't that true, sir?

A. No, sir.

Q. It is not?

A. Because you neglect the enterprise factor.

Q. I didn't use that, sir. I didn't say enterprise; I said you had used up $200,000 of cash in the bank and in exchange for it you had tables and chairs.

A. That's true but I don't agree that they are merely worth $200,000 because you have neglected the contribution of enterprise which caused you in the first instance to spend this money for lumber and for labor to make a product that is useful.

* * * * * * *

[fol. 384] By Mr. Wixon:

Q. Now at that point, sir, and using our taxing approach now, dollars, real dollars, where is your income?

A. If the value of the chairs which you use in your illustration is no greater than the costs you incurred there is no income. If the value of those chairs is greater than the costs you incurred there will be a net income. If the value is less than the costs you incurred there will be a net loss.

Q. Would it be taxable income, sir?

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The Witness: The answer is I have not studied the law and cannot answer the question.

* * * * * * *

The Court: I would like to ask you some questions. These are some questions that I asked other economists.

Let's take the case that you gave about the increment of the house. Let's suppose, say, the house cost $10,000 and finally it valued up to $15,000. Then the owner sells it. Now, would you say that the sale does not produce the income? Suppose the house burns down before he sells it?

The Witness: Well, now I think you have made it possible for me to answer that question, because I was a bit puzzled by it.

[fol. 385] The Court: I know, because you will say he really lost the income by fire.

The Witness: Yes; that if he would recover $15,000 if he had insured it for that amount.

The Court: We are not talking about insurance, we are talking about income. Let's take the case where the General Motors loads six cars on one of these trucks that you see on the road—almost run over you most of the time—and he is coming down a hill, say, in Pennsylvania, it has a wreck. Now, there wouldn't be any income from those automobiles, would there?

The Witness: Except if they were insured.

The Court: Suppose they were not insured?

The Witness: Then there would be a loss; yes, sir.

The Court: There would be no income at all?

The Witness: No.

The Court: But let's take another one that comes into the District and is sold, then it is income, isn't it?

The Witness: Yes, sir.

The Court: Well, isn't the sale what produces the income?

The Witness: If I were to say Yes to that I would be double counting then because we will attribute the income [fol. 386] being produced there to other factors than production.

The Court: I am not asking you what you would do, I am asking you as an economist.

The Witness: I would have to say No, that in the economist's way of thinking, the sale does not produce the income. It is at the time of the sale that the income is realized.

The Witness: For example—

The Court: We are getting into semantics over here. I didn't know we were going to do that today. But it results from the sale, doesn't it? You will go that far, won't you?

The Witness: I would say the income results from the fact that you produced the house, not from the fact that you sold it.

The Court: Let's suppose that as soon as the automobile was manufactured the government comes along like somebody wins money in a game of some kind like these people that win ten or fifteen thousand dollars, the government comes and gets it. Now, let's suppose the government came to General Motors, as soon as they manufacture a car, pay us the income tax on it. Do you think they could do it?

The Witness: In the case of General Motors in recent years they probably could because they are very successful, but it wouldn't be practical.

[fol. 387] The Court: Let's take someone who manufactures something and after he manufactures it it is worth more than what it costs him. The government comes and says, you have earned income, pay it. What do you think the answer would be?

The Witness: Well, his answer would be that this would be a very unfair method—

The Court: He would say, I haven't had any income, wouldn't he?

The Witness: Well, sir, I am not used to disputing with the tax authority rulings. Probably he would.

The Court: I know, I am asking you.

The Witness: He might say No, if it is a liability that has accrued I will pay it. There are two ways of accounting, namely, one, a cash basis for accounting and an accrual basis.

The Court: Suppose a man is on a cash basis?

The Witness: On a cash basis he would say rightfully, I have no income, that is right. On an accrual basis he would have to say that he has—he might have to say that he has some income.

The Court: I am going to ask you another question that I asked the others. In this hypothetical question, the law is cited and one of the provisions is that if the business is carried on both within and without the District the net income from that segment must be deemed to be income [fol. 388] within and without the District.

Now let's suppose that you have this two factor formula, property and payroll, and there are no advertising expenses, I don't know whether there is any proof of it here, how you can justify your testimony with that provision in mind with just the two factor formula, one for payroll and property? It is impossible, isn't it?

The Witness: I think it is impossible.

The Court: Let's suppose now, let's take the other side, what I asked yesterday. Let's suppose that you have one factor of sales, would it be possible to—

The Witness: It would not be possible to justify it in view of that provision.

The Court: Am I right in your view that in order to comply with the law it would have to have all three factors?

The Witness: Insofar as I understand the law as I heard it here from your Honor during the last two days, that is my view, then.

The Court: I am charged by the Court of adopting a formula, if the District's new regulation is not valid, that may be right, but I may have to do that, and in light of the law I have got to find out now, and I want all the help I can get—this is addressed to counsel, too—I have got to adopt a formula which I think is reasonable.

[fol. 389] Let's suppose that I come to a conclusion now that I have to do that. What would you suggest as a proper formula, bearing in mind that if the business is carried on both within and without the District of Columbia it must be deemed to be income from both sides of the line, what would you suggest as a proper formula from an economic standpoint?

The Witness: The proper formula that would meet this law and every conceivable circumstance of sales and production within and without the District would have to be, then, a three factor formula, in my opinion.

The Court: Are you familiar with the uniform formula?

The Witness: I have read it a number of times; yes, sir.

The Court: What is your opinion with respect to that?

The Witness: My opinion is that as a practical matter this formula is satisfactory.

The Court: Applied to a business such as—

The Witness: And applied to any manufacturing business.

The Court: All right.

Mr. Wixon: Just a couple of questions.

The Court: Yes.

By Mr. Wixon:

Q. As a matter of economics, is it accepted that labor and capital contribute equally to the production of income or have economists ever thought that there might be some [fol. 390] difference in the contribution?

A. Oh, there is a difference in the quantitative contribution, yes, sir; labor gets the bulk of the income of the country.

Q. I mean the production of income, sir.

A. Yes.

Q. Have the economists ever considered the possibility that as a matter of economics it could be said that, say, capital contributes more than labor to the production of income or that labor contributes more than capital to the production of income?

A. Yes, in given situations where you have a large amount of capital and a small quantity of labor the contributions of capital is said to be larger. The most obvious illustration is a hydroelectric plant where there is very little labor. The other illustration of the opposite is some service industries which are composed mostly of labor, very little capital.

Q. Well, any proper formula, even the uniform formula that Judge Morgan has referred to here, ought to have some consideration given to the potentials that you have just expressed in respect of the different contributions that may be inherent in the production of income, labor and capital being the two elements?

A. I doubt whether any practical formula can be devised which would take into account all of these variations.

[fol. 391] The Court: What Mr. Wixon asked you, would the fact taking into consideration that in some instances labor is greater than capital and in some instances capital is greater than labor—isn't that right, Mr. Wixon?

Mr. Wixon: Yes, sir.

The Court: The formula does. The uniform formula does, it is divided into three parts. You don't lump them all together. You first get your property factor and your payroll factor, and if the payroll is greater, in that state, why, it would be reflected.

Mr. Wixon: We are not talking about other places, we are talking about the District of Columbia. I haven't got the slightest interest in the uniform formula. I am not dealing with fifty states and your Honor has been, I think, when you are talking about a uniform formula.

The Court: I am talking about intrinsically.

By Mr. Wixon:

Q. As a matter of economics, I understand you to agree —I might have misunderstood you—but I understood you to agree that in the production of income variations occur in respect of the amount of income which may be produced by labor on the one hand or capital on the other.

A. You understand me correctly, that is my view.

[fol. 392] Q. All right, if you used such a formula giving equal weighting to labor and capital, and the third one was in the uniform sales, if you gave equal weight to them would you not run into the difficulty that labor might have been overstated in one case as an element and capital overstated as an element in another in respect of the income produced from the economist's standpoint?

A. Now, these are proportions in the formula.

The Court: That is right; proportions.

The Witness: And it is not clear to me how a variation in the relative amounts of labor and capital used in various industries would work any injustice in apportionment, with a uniform formula.

By Mr. Wixon:

Q. Do you think there is any such thing as a perfect formula, Professor?

A. Well, in practice, no, I have never seen any.

Q. Would you agree that if we were to sit down and consider the matter that perhaps other formulas than the three factors of property, payrolls and sales, might be devised which would be equally as good?

A. I think there might be, yes. I don't know what it would be, but—

The Court: In that connection, Mr. Wixon, that is exactly what I want counsel to do. If you all have any suggestions, please give them to me.

[fol. 393] Mr. Wixon: Oh, I have one, sir, the formula approved by the United States Court of Appeals in May 1961.

The Court: But I would say, Mr. Wixon, that even though we cannot expect a perfect formula we should at

least have a formula that makes an attempt to recognize the basic economic facts and is not based upon an erroneous conception of the economic facts.

By Mr. Wixon:

Q. Oh, no one would disagree with that, no one wants error. But you do agree that payroll, for example, and property, using those two elements, would be the best formula to use, conceptually?

A. I conclude that either that or a three factor formula would be satisfactory so far as I am concerned. I want to make it clear, however—

Q. I said conceptually, sir; as an economist if you were going to pick a formula that you would use labor and capital?

A. Well, we have the difficulty that I have referred to of allocating to a jurisdiction some of these input factors or costs.

Q. I didn't mean that, sir; I meant as an economist income from your standpoint is the result of labor and capital. Therefore, those two elements are the things which produce income.

A. Labor, capital and enterprise.

Q. Which is not really measurable except to go back [fol. 394] into one of the two other elements that we have talked about, labor and capital?

A. Yes, I want to make it clear that I agree that a three factor formula is satisfactory for the reasons that I have indicated, that it in its workings, it would give some recognition to these expenses which are otherwise not directly allocable to a given jurisdiction, not because I hold the view that the sale itself creates income in a manufacturing company.

His Honor asked me about cases of sale of property or let's say of stocks, and in that case it is very difficult to apply the conventional economic doctrine that the net income is created by factors of production. For example, if I buy a hundred shares of U. S. Steel today and sell it at a profit a year from now it is very difficult to explain this type of profit by the formula of factors of production

and I didn't so intend it to be explained. I was thinking of profit of corporations such as we have in the case of General Motors.

Q. Let me ask you about that sales matter just one little bit more.

You said that sales could be used because it would tend to take in some of the elements that are left out by the other two, payroll and property, the other two factors of payroll and property. I think you used advertising as an example.

Now, it is true, is it not, Professor, that unless you have some criterion for sales, that is to say, the contribution it might make in this area, that you might overload this formula by giving equal weight to sales. You might not [fol. 395] give as much as the one-third weight would give it. I mean it might not have produced as much as the one-third weight.

A. First, I would like to correct one statement before replying.

Q. Surely.

A. It is this, that I do not voice approval of the three factor formula because I believe that there are other factors of production in addition to capital, labor and enterprise.

Now, second, whether an equal weighting is the appropriate thing is a matter on which I can't offer an opinion because that would require a great many statistical studies of how such a formula would work out in a great number of instances, and my experience is such that before I would offer an opinion about equal weighting or proportionate weighting I would want to see how it works in those cases. Maybe I ought to be able to deduce it, the result a priori, but my experience leads me to conclude that I wouldn't venture that.

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Redirect examination.

By Mr. Barnes:

Q. The question I ask might not be the same one but it bears on the issue. This is the question as to how we may properly be sure that the statutory requirement that

income from business conducted within and without the [fol. 396] jurisdiction be deemed to arise within and without the jurisdiction. In the hypothetical question involving General Motors Corporation it is posed that all the manufacturing activities of the corporation are outside the District, that there are in the District a number of employees who are engaged in sales and promotional activities, and, of course, we are concerned with the proceeds from sales made to customers within the District.

Now, the question is, would a two factor formula applied to that situation meet the statutory requirement that the income be divided between within and without?

A. Yes, it would. When I indicated that there are circumstances where it might not it was to take into account a situation where a corporation had no property or no payroll within the District but did have sales.

Q. Let me ask you further about that one.

Remember that what the statute is talking about is a business which is conducted within and without the District and that Judge Morgan asked you to disregard such things as advertising.

Now, if we have no property and no payroll in the District and we are disregarding advertising, in your opinion is there any business being conducted in the District? We have customers here.

A. From my point of view I would say No, although I suppose this is a matter of law.

[fol. 397] Q. I just wanted to clarify what your answer was before and I have no further questions.

Recross examination.

By Mr. Wixon:

Q. Along that line, Professor, if General Motors produced all of its products, all of its employees but one were in the State of Michigan and all of its property, completely all of its property, was in the State of Michigan, and it sold all of its products in the District of Columbia through that one employee, you would say that the income was produced, so far as the District of Columbia was con-

cerned, only in relationship of that one employee, let us say, to the 50,000 employees General Motors has. That is true, isn't it?

A. Under the two-factor formula; yes, sir.

Q. And there being no property, you would not include that at all, so that would become a zero as far as the District was concerned?

A. That is correct.

Q. And, therefore, following it out, all taxable income, if any there was, would be subject to tax in the State of Michigan alone? That is true, is it not, sir?

A. All except the small portion that you indicated.

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[fol. 398]

BEFORE THE DISTRICT OF COLUMBIA TAX COURT

PETITIONER'S EXHIBIT No. 22

LIST OF (a) ALL STATES IN WHICH GENERAL MOTORS CORPORATION IS ENGAGED IN BUSINESS WHICH IMPOSE STATE INCOME TAXES, OR TAXES BASED ON INCOME, AND (b) RELATIVE STATUTES, INCLUDING SPECIFIC SECTIONS IMPOSING TAX AND PRESCRIBING APPORTIONMENT FORMULAE

Alabama	Alabama Code of 1940, Title 51, Chapter 17, Sec. 373
Arizona	Arizona Revised Statutes, 1956, Title 43, Chapter 1, Secs. 43-102(b), 43-135(C)(g)
Arkansas	Arkansas Statutes, 1947, Title 84, Chapter 20, Secs. 84-2004(B), 84-2020.9
California	California Revenue and Taxation Code, Division II, Part 11, Chapter 2, Sec. 23151; Chapter 17, Sec. 25101
Colorado	Colorado Revised Statutes, 1953, Chapter 138, Taxation II, Article 1, Secs. 138-1-3, 138-1-28

Connecticut	Connecticut General Statutes, Title 12, Chapter 208, Secs. 12-214, 12-218
Delaware	Delaware Code, Title 30, Part II, Chapter 19, Secs. 1902, 1903
Georgia	Georgia Code of 1933, Title 92, Public Revenue, Division 1, Part IX, Chapter 92-30, Secs. 92-3102, 92-3113
Iowa	Iowa Code of 1954, Title XVI, Chapter 422, Division III, Secs. 422.33, 422.33(1)
Kansas	Kansas General Statutes of 1949, Chapter 79, Article 32, Sections 79-3203(b), 79-3218
Kentucky	Kentucky Revised Statutes, Title XI, Chapter 141, Sections 141.040, 141.120 (4)(b)
Louisiana	Louisiana Revised Statutes of 1950, Title 47, Sub-Title II, Chapter 1, Part I, Sub-Part B, Secs. 31, 245-F
Maryland	Maryland Annotated Code of 1957, Article 81, Secs. 288(b), 316
Massachusetts	Massachusetts General Laws of 1932, Chapter 63, Secs. 39, 41
Michigan	Compiled Laws of the State of Michigan, 1948, Chapter 205, (Act 150 of 1953) Sections 205.552(2), 205.553(1)
Minnesota	Minnesota Statutes of 1957, Chapter 290, Sections 290.02, 290.19
Missouri	Missouri Revised Statutes of 1949, Title X, Chapter 143, Secs. 143-030, 143.040(2)
Montana	Montana Revised Codes of 1947, Title 84, Chapter 15, Secs. 84-1501, 84-1503

New Jersey	New Jersey Revised Statutes of 1937, Title 54, Sub-Title 4, Part 1, Chapter 10A, Sections 54:10A-5, 54:10A-6
New York	New York Consolidated Laws, Chapter 60, Article 9-A, Secs. 209, 210(3)
North Carolina	North Carolina General Statutes 1943, Chapter 105, Sub-Chapter 1, Article 4, Schedule D, Secs. 105-134, 105-134(6)
North Dakota	North Dakota Revised Code of 1943, Title 57, Chapter 57-38, Secs. 57-3811, 57-3812
Oklahoma	Oklahoma Statutes 1951, Title 68, Chapter 21, Secs. 876, 878(g)
Oregon	Oregon Revised Statutes, Chapter 317, Sec. 317.070; Chapter 314, Sec. 314.280
Pennsylvania	Purdon's Pennsylvania Statutes 1933, Title 72 (based on Act of May 16, 1935, P.L. 208), Secs. 3420c, 3420(b)
Tennessee	Tennessee Code, Title 67, Chapter 27, Secs. 67-2701, 67-2706
Utah	Utah Code Annotated 1953, Title 59, Chapter 13, Secs. 59-13-3, 59-13-20
Virginia	Virginia Code of 1950, Title 58, Chapter 4, Article 1, Secs. 58-77, 58-131.2
Wisconsin	Wisconsin Code of 1947, Chapter 71, Secs. 71.01, 71.07(2)

[fol. 399]

BEFORE THE DISTRICT OF COLUMBIA TAX COURT

FACTS STIPULATION—April 10, 1961

The parties by their respective counsel stipulate and agree solely for purposes of these cases as follows:

1. The purpose of this Stipulation is to describe Petitioner's activities and method of doing business within the

District of Columbia during the calendar years 1957 and 1958 and to relate those activities to the sales figures agreed upon in a separate Numbers Stipulation, dated March 29, 1961. Either party may introduce additional evidence upon the trial of these cases, except with respect to the activities of the offices and personnel within and without the District as described herein as to which Petitioner and Respondent elect to stand on the facts and descriptions of activities set out in this Stipulation. The same election is made in respect of the "Numbers Stipulation" submitted in these cases. For convenience the following statements of fact are generally in the present tense but relate to and are true for the calendar years 1957 and 1958 unless otherwise stated.

General Description of Business

2. Petitioner's principal business is the manufacture and sale of automobiles, trucks and other motor vehicles, parts and accessories therefor and engines. Petitioner does not have any plant or conduct any manufacturing or assembly operations in the District of Columbia. Petitioner does not have any office, warehouse or other place of business within the District or any officer, agent or representative [fol. 400] having such an office or other place of business except as specifically set out herein. Petitioner has been selling its products, through a subsidiary or subsidiaries prior to January 3, 1942, and thereafter directly, to "authorized" dealers and others in the District of Columbia since Petitioner was organized in 1916.

3. In addition to its central management staffs, Petitioner is organized into a number of divisions, not separately incorporated. These divisions, although centrally controlled, operate substantially independently of one another and are concerned with the manufacture, assembly and/or sale of one or more of Petitioner's products. Petitioner's methods of doing business and selling and distributing its products as described herein are the same throughout the country.

Sales to Dealers by Petitioner's Car and Truck Divisions

4. Pontiac Motor Division

(A) The Pontiac Motor Division is an unincorporated division of Petitioner and is concerned with the manufacture and sale of Pontiac automobiles, parts and accessories.

(B) The Pontiac sales organization is headquartered in Pontiac, Michigan. For administrative convenience, the country is divided into a number of "regions," each of which is subdivided into a number of "zones." The Pontiac Regional Office whose territory includes the District of Columbia is located in New York City, New York. A regional [fol. 401] manager supervises and directs the activities of this office.

(C) The Pontiac Zone Office whose territory includes the District of Columbia is, as throughout 1957 and 1958, located in Chevy Chase, Maryland. In addition to the District of Columbia, the zone territory includes most of Virginia and Maryland, and small parts of Pennsylvania and West Virginia. There are approximately 120 Pontiac dealers in the zone, four of which were in the District of Columbia in 1957 and 1958.

(D) The Zone Office personnel total 22. Edward M. Krotine has been zone manager since September 1958 and is in charge of the over-all activity of the Zone Office and territory. In addition, there is an assistant zone manager, who spends about 50% of his time in the office and the balance contacting dealers in the entire zone and whose primary duty is supervising the district managers; a business management manager, who spends 75% of his time visiting dealers; an office manager (car distributor) and his assistant, who spend 100% of their time in the office; a parts and service manager, who spends 75% of his time visiting dealers; a claims administrator and his assistant, whose duties are confined to warranty adjustments, spending 90% and 100% respectively of their time in the office; three service representatives, who spend 100% of their time visiting dealers' parts and service departments; a school instructor, who works exclusively in the training school at

Fairfax, Virginia; four district managers, who spend 100% of their time visiting dealers; and six clerks, stenog-
[fol. 402] raphers, etc., who spend all their time in the office.

(E) In addition to supervising the district managers (whose activities are hereinafter described), the zone manager and his assistant make periodic visits to Pontiac dealers in the District of Columbia and elsewhere in the zone. These trips occur approximately once a month. The purposes of these trips are (1) to work with the dealers concerning market opportunities, (2) to promote the sale of promotional literature, and (3) to maintain dealer interest in items that will help the retail sale of automobiles. The district managers are primarily responsible for the foregoing activities, but are supported by the zone manager, the assistant zone manager, and as hereinafter indicated, the zone department heads.

(F) The business management manager spends approximately 75% of his time visiting Pontiac dealers within the zone territory, including the dealers within the District of Columbia. His primary duty is to assist Pontiac dealers within the zone territory in making their operations more profitable. This is done by the suggestion of ideas which strengthen dealer business. It is also his duty to analyze dealer business procedures and activities. If, as a result of this analysis, a weak spot is discovered, he may discuss it with the dealer involved and suggest remedial action or, as is usual, he advises the district manager who regularly contacts the dealer involved, and the district manager actually handles the matter with the dealer. These suggestions may, for example, take the form of a reduction in
[fol. 403] used-car inventory, the reduction of excess overhead or the reduction of used-car allowances if above average.

(G) The office manager (car distributor) and his assistant have no dealer activity as such within the District of Columbia. However, they do process orders from dealers and as a result of these orders call the specific dealers in regard to said orders.

(H) The zone parts and service manager checks with the dealer and makes recommendations related to dealer service facilities and maintains a check on the supply of parts that an individual dealer keeps on hand. Promotion of the best possible service for both new and used automobiles is also one of his activities. Suggestions to the dealers for special material to be used in promotional activity, as it relates to the servicing field, is also one of his duties, for example, materials advertising special winter service. If he sees fit, he recommends an increase in the supply of parts maintained by a dealer. Generally, the dealer mails his parts orders directly to a General Motors Parts Division warehouse in Baltimore, Maryland, and the orders are filled by shipment, f.o.b. warehouse, directly to the dealership. He receives product complaints from retail customers, and he checks to be sure that the dealer has satisfied his warranty obligations to the retail customer. He also attends meetings of dealers' service managers' clubs, but no such club is maintained in or meets in the District of Columbia. The service managers of the Pon-
[fol. 404] tiac dealers in the District and surrounding area attend such meetings held at Petitioner's training center in Fairfax, Virginia.

(I) The zone claims administrator and his assistant spend 90% and 100% respectively of their time in the Zone Office. They receive and process dealers' claims pursuant to express warranties running from Petitioner to the dealers, and they also receive and handle complaints from retail customers. They process more warranty claims than does the zone parts and service manager. The claims administrator from time to time visits dealers to determine the propriety of warranty claims made by the dealers since Petitioner reimburses the dealers for the costs of these claims.

(J) In addition to the zone parts and service manager, there are three service representatives whose activities within the zone territory are essentially the same as those of the zone parts and service manager. During 1957 and 1958 there was only one service representative in the zone, and he devoted his entire time to refereeing customer com-

plaints. Other service matters were handled by the district managers.

(K) There are four district managers attached to the Pontiac zone. One of them works a territory which includes the District of Columbia and the surrounding metropolitan area in Virginia and Maryland, plus a small part of West Virginia. There are 28 Pontiac dealers in this area, three of which are in the District of Columbia. There were four [fol. 405] Pontiac dealers in the District of Columbia in 1957 and 1958. The district manager lives in Maryland. He has no office and no business telephone. Pontiac makes no contributions to the expenses of his home or telephone, except to reimburse him for specific charges for long distance telephone calls. He reports to the Maryland Zone Office about twice a week to make up reports.

(L) The district manager calls on the Pontiac dealers in the District of Columbia at least once a week. He urges them to order promotional materials and special tools, which are supplied by other manufacturers (not the Petitioner), the charges for such materials and tools being billed to Pontiac and rebilled to the dealers at cost. He solicits orders as necessary to round out the dealers' inventories of parts and accessories, picking up some orders, but most orders are sent directly by the dealers to the General Motors Parts Division warehouse in Baltimore, Maryland. He assists the dealers in holding salesmen's meetings about six times a year, discusses business-getting methods with the dealer's sales manager and such matters as sales department organization, advertising, demonstrations and salesmen's incentives. He advises on the reconditioning of, allowances for, and inventory of used cars. He tries to assist the dealers in maintaining proper inventories of new automobiles, neither too large nor too small. Usually, dealers want more cars than Pontiac is willing for them to have, it being considered undesirable to permit [fol. 406] inventories to become excessive. At "clean-up time" (immediately before the introduction of new models) it is sometimes necessary to urge dealers to purchase additional cars to build up their stocks during the model

changeover period. The district manager keeps the dealers informed on what automobile models are more salenble than those that presently make up the dealer's existing stock.

(M) Once a month, the district manager obtains from the District of Columbia Pontiac dealers projections of their new automobile requirements for the next three months. These are obtained rather informally with most of the emphasis directed to obtaining information on the requirements for the month ahead for production planning purposes. Actual orders for new automobiles are sent by the dealers directly to the Pontiac Zone Office in Maryland, although in the case of the Washington metropolitan area (including the District of Columbia), the district manager may occasionally pick up the orders and carry them to the Zone Office. The orders are received and processed at the Zone Office and then forwarded for acceptance (or rejection) to a Buick-Oldsmobile-Pontiac assembly plant in Wilmington, Delaware, (or to other plants outside the District of Columbia) where they are filled by shipment, f.o.b. factory, by common carrier directly to the dealer's place of business. A dealer may finance his new car purchases through General Motors Acceptance Corporation (a wholly owned General Motors subsidiary with an office in the District of Columbia), in which case security title [fol. 407] passes to GMAC at the factory. Dealers may also use other financing methods or pay cash, in which case security title may pass at the factory or the shipment may be on bill of lading with sight draft attached. The Pontiac dealers in the District of Columbia during 1957 and 1958 were all financed under the GMAC plan. The Zone Office maintains a small stock of cars in warehouses outside the District and sells 50-100 a month therefrom. Dealers go directly to the warehouses to pick up these cars. The Zone Office makes approximately 3 or 4 sales a month to foreign diplomatic representatives (to simplify exemption from federal excise taxes). The Zone Office has no contact with sales to the United States Government.

(N) In addition to the "90-day" projection of automobile requirements, the dealer submits a "10-day" report of

sales and inventories and a monthly financial statement. The dealer sends these papers directly to the Zone Office. The purpose of the "10-day" report and the "90-day" projection is to aid the zone and, through consolidation, the national headquarters in Pontiac, Michigan, to plan production schedules. The financial statements are also forwarded to Pontiac, Michigan, but are analyzed locally by the zone business management manager and the zone manager to determine any weakness in an individual dealer's operations when compared with dealer averages. When a weakness is discovered, the district manager is told to discuss it with the dealer involved. The more serious cases [fol. 408] are handled with the dealer by the zone manager and, as mentioned above, by the business management manager. The district manager, armed with knowledge of dealer averages, gives the dealer advice and assistance on almost every phase of his business.

(O) Regular visits to the zone by other than zone personnel are made as follows: The Pontiac general manager and general sales manager, approximately once a year; the assistant general sales manager, approximately three times a year; the regional manager, approximately six times a year. The general manager and the general sales manager are located in Pontiac, Michigan; the assistant general sales manager and the regional manager are located in New York City, New York. These visits are not fixed but occur with the average frequency indicated. Occasionally a department head from the sales staff in Pontiac, Michigan, might call. These out-of-town visitors are usually in the zone to attend dealer meetings conducted by Pontiac, which are usually held in Fairfax, Virginia, but occasionally at a hotel in Washington, D. C. Sometimes these people make good-will calls on individual dealers. There are about 10 dealer meetings a year, one or two of which include all Pontiac dealers in the zone and are held in a hotel in Washington, D. C., the general purposes of which are for Pontiac personnel to describe new products, new sales promotion materials, etc.

(P) An annual automobile show for all makes is staged [fol. 409] in Washington, D. C., by the Washington Auto

Trade Association whose membership includes the Metropolitan area automobile dealers of all manufacturers, that is, General Motors, Ford, Chrysler, etc. The District of Columbia General Motors dealers, including Pontiac dealers in the District as well as outside the District, participated in this show in 1957 and 1958. Pontiac zone personnel actively participate in organizing and setting up the Pontiac dealer's display at the show. Pontiac supplies the cars which are then sold to the dealers after the show. Pontiac also provides a cut-away chassis exhibit which includes light standards for flowers. There is usually one, sometimes two, zone personnel in attendance at the show at all times to explain and describe the General Motors exhibits. The dealers pay all the expenses of the show except the cost of flowers and the salaries of the zone personnel involved.

(Q) In 1957 and 1958, there were four Pontiac dealers in the District of Columbia: Jack Blank Pontiac, Inc. (name changed from Arcade Pontiac Co., as of October 31, 1957), Flood Pontiac Co., Star Pontiac Co., Inc., and McKee Auto Service, Inc. These dealers were all appointed prior to 1957.

(R) The assistance and advice provided to dealers, and the other activities as above described are a form of sales promotion to aid in attracting retail customers into the dealerships and in obtaining retail sales, and as a result of such retail sales, the wholesale orders from dealers to [fol. 410] Petitioner flow automatically and are not ordinarily specifically solicited.

5. *Oldsmobile Division*

(A) The activities and method of doing business within the District of Columbia of Petitioner's Oldsmobile Division are substantially identical in all material respects to those of the Pontiac Motor Division described in paragraph 4 hereof, it being understood also that the activities described for Pontiac Motor Division and Pontiac personnel, when referred to in connection with Oldsmobile Division, refer to and are applicable to Oldsmobile activities and

personnel in each case and to avoid repetition, are incorporated for Oldsmobile by reference. The Oldsmobile sales organization operates through a system of "regions" and "zones." The Zone Office whose territory includes the District of Columbia is, as during 1957 and 1958, located in Silver Spring, Maryland.

(B) During 1957 and 1958, there were five Oldsmobile dealers within the District of Columbia: Alber Oldsmobile, Inc., Capitol Cadillac-Oldsmobile Co., Colonial-Oldsmobile Co., Paul Brothers, Inc., and Pohanka Service, Inc. These dealers were all appointed prior to 1957. Sales to and business activities with them were handled in the same manner as were the Pontiac sales and business activities described in paragraph 4 hereof.

6. *Buick Motor Division*

[fol. 411] (A) The activities and method of doing business within the District of Columbia of Petitioner's Buick Motor Division are substantially identical in all material respects to those of the Pontiac Motor Division described in paragraph 4 hereof, it being understood also that the activities described for Pontiac Motor Division and Pontiac personnel when referred to in connection with Buick Motor Division, refer to and are applicable to Buick activities and personnel in each case and, to avoid repetition, are incorporated for Buick by reference. The Buick Zone Office whose territory includes the District of Columbia is, as during 1957 and 1958, located in Silver Spring, Maryland.

(B) During 1957 and 1958 there were four Buick dealers within the District of Columbia: Emerson and Orme, Inc., Stanley H. Horner, Inc., and Otho Williams Buick, Inc., and Peake Buick, Inc. These dealers were all appointed prior to 1957. Sales to and business activities with them were handled in the same manner as were the Pontiac sales and business activities described in paragraph 4 hereof.

7. *Chevrolet Motor Division*

(A) The activities and method of doing business within the District of Columbia of Petitioner's Chevrolet Motor

Division are substantially identical in all material respects to those of the Pontiac Motor Division (as described in paragraph 4 hereof, it being understood also that the activities described for Pontiac Motor Division and Pontiac personnel when referred to in connection with Chevrolet [fol. 412] Motor Division, refer to and are applicable to Chevrolet activities and personnel in each case). With the modifications hereinafter mentioned, the description for Pontiac is incorporated herein by reference. Chevrolet maintains a regional office in Washington, D. C. This office consists of a regional manager, twelve department heads and various clerical assistants. The regional office supervises five zones, including the Baltimore zone whose territory includes the District of Columbia. No dealer orders for Chevrolet automobiles pass through the regional office in Washington. They go directly from the dealers to the Baltimore Zone Office and then to the Chevrolet assembly plant in Baltimore or to other plants outside the District of Columbia. The regional office receives from the zone offices within the region 10-day and monthly sales reports which are consolidated and forwarded to Detroit, Michigan. During periods of short supply, it receives statements of regional allotments of cars and trucks from the Detroit headquarters which it breaks down and allots among the five zones within the region. The zone, in turn, allocates these cars and trucks among the dealers in the zone. Expense reports and payrolls are approved in the regional office before being sent to the Chevrolet assembly plant at Baltimore for payment. The regional office receives copies of other reports (similar to those described for the Pontiac Motor Division) made by the zones to Detroit.

(B) The Zone Office for the Baltimore zone is, as during [fol. 413] 1957 and 1958, located in Baltimore, Maryland, and consists of approximately 40 employees including the usual district managers, service representatives, etc. Two district managers, attached to the Baltimore Zone Office, neither of whom lives in the District, each serves a separate territory. Each such territory has within it three dealers in the District of Columbia and five outside. These district managers are supervised by a city manager who is attached

to the Baltimore Zone Office and lives in Maryland but who has office space assigned to him in the regional office in Washington, D. C., and all necessary facilities and regional office personnel assistance are available to him. The district managers send their reports to the Zone Office, but the city manager occasionally receives copies of some when they concern projections of dealers' requirements of cars and trucks. The city manager spends about 40% of his time in the office and the balance visiting the sixteen Chevrolet dealers in the metropolitan area, including the six in the District of Columbia. The city manager also breaks down statements of allotments of cars and trucks, as described above, among the metropolitan area dealers in order to provide a fair distribution to the dealers during periods of shortage. The Zone Office in Baltimore forwards to the city manager owner complaints involving the metropolitan dealers when such complaints concern the details of transaction (such as a complaint that the dealer has overcharged the customer), rather than product failure, the latter being handled through the zone service manager and the service [fol. 414] representatives. The city manager himself, or through the district manager, attempts to mediate such complaints to the satisfaction of both the dealer and his customers. Orders for Petitioner's products do not pass through the city manager's office.

(C) A fleet manager works out of the Chevrolet regional office in Washington, D. C. He contacts local and national fleet users. He supplies technical information and promotes fleet orders which are placed by the retail customers with dealers. He spends approximately 40% of his time in Washington. Fleet orders come from large commercial users (including some in the District of Columbia), municipalities and states. The fleet manager assists dealers in the preparation of bids. He is technically trained and assists fleet users in the preparation of specifications, particularly as to trucks, so that Chevrolet will not be inadvertently excluded, and advises fleet users on what kind of equipment will satisfy the users' requirements. Fleet sales are made by Chevrolet directly to Chevrolet dealers who in turn resell to the fleet users.

(D) There were five Chevrolet dealers, all of whom were appointed before January 1, 1957, within the District of Columbia during 1957 and 1958. Another District dealer, who was also appointed prior to January 1, 1957, was bought out in 1957 and a new District dealer was installed in his place. The procedure for filling an open dealership is illustrated by this case: When the opening became avail- [fol. 415] able, the zone manager had a file of waiting applications. From that file he selected an individual who had been a Buick dealer and was later hired by Motors Holding Division to liquidate another Buick dealership. His ability, as demonstrated in those two operations, led to his tentative selection. Thereafter, his credit was checked in relation to his earlier dealership in Maryland, with the city manager and the district manager assisting in this operation. The same was true as to his operations in another dealership in Virginia. He had been a former General Motors employe and his record there was checked. Inasmuch as his application included a request for financial assistance from Motors Holding Division, that Division conducted its own check. (The function and activities of Motors Holding Division are described hereinafter in paragraph 20.) The formal application was then worked out with the applicant and Motors Holding Division in the Motors Holding Division office in Washington, D. C., although this operation would usually be performed in the Zone Office. The application, with the zone manager's favorable recommendation, was then presented to the regional manager in Washington along with recommendations from others. The regional manager did not interview the applicant, but approved the application and forwarded it to the assistant general sales manager in Detroit. Because a metropolitan area was involved, the assistant general sales manager's staff checked with the Distribution Staff in the General Motors Central Office. Thereafter, the application [fol. 416] was approved by the general sales manager, which check was reported to the zone manager and by him to the prospective dealer. The buy-out of the former dealer's assets was negotiated between the two dealers, with the assistance of Motors Holding Division. The Zone Office did not participate in that operation, except to assist in

the inventorying, most of which was done by an outside firm. Chevrolet took back from the old dealer some excess inventory of parts, accessories and automobiles. The Dealer Selling Agreement was then executed in the Zone Office, which is standard procedure. On that occasion the zone department heads explained to the dealer what they could and would do to assist his operations (as described in those paragraphs of this Stipulation dealing with the activities of zone personnel in their relation with dealers), and he placed initial orders for advertising and similar materials.

8. *Cadillac Motor Car Division*

(A) The sales organization of Petitioner's Cadillac Motor Car Division is headquartered in Detroit, Michigan. Unlike the other car divisions, its products are merchandised principally through independently-owned distributorships who in turn appoint dealers and perform functions similar to those of the Zone Offices of the other car divisions. In addition, there are five Cadillac factory branches which serve as distributors, none of which branches is located in or serves the District of Columbia. Each distributor also acts as a retail dealer. Distributors are responsible for [fol. 417] the selection, appointment, and development of dealers within their territory. Cadillac enters into a "Distributor Selling Agreement" (copy attached as Exhibit 1-A) with each distributor who in turn enters into dealer selling agreements with its dealers. Cadillac is not a party to these dealer selling agreements.

(B) As during 1957 and 1958, there is one distributor located in the District of Columbia, Capitol Cadillac-Oldsmobile Co. This distributorship, which is independently owned and not a Cadillac branch, was appointed on March 29, 1934, and is the only retail Cadillac outlet in the District of Columbia. This distributor has, as during 1957 and 1958, two Cadillac dealers under him, one in Bethesda, Maryland and the other in Alexandria, Virginia.

(C) Contact with the distributors, and through the distributors with the dealers, is maintained on behalf of Cadillac by employes of the Cadillac Motor Car Division known

as "district managers" and "district parts and service managers." The district manager and the district parts and service manager having contact with the District of Columbia distributor cover a territory which includes the District of Columbia, Virginia, Maryland, except the eastern shore, and small parts of West Virginia, Tennessee, Pennsylvania and North Carolina. There are seven distributors and forty-nine dealers in the territory, which is known as the "Washington district." Edward J. Davis was the [fol. 418] district manager from June 1954 to October 1960. His home is in Dallas, Pennsylvania. At his own expense, he leased living quarters in Washington, D. C. He was not listed in the telephone directory but used the telephone listed in his landlady's name. He used the District of Columbia distributor (Capitol Cadillac-Oldsmobile Co.) as an address for receipt of mail and telephone messages. He had no desk nor telephone listing at the Washington distributorship. Whenever in the Washington area, he would make short daily stops to pick up mail and messages. From time to time he was absent from the Washington area for a week or ten days contacting distributors and dealers in other parts of his territory. At such times, the Washington distributor would, when requested, forward his mail to him. Generally, he prepared his reports at his quarters in Washington or wherever he was staying while on the road.

(D) Mr. Davis called on each distributor at least once a month and in the case of the two largest distributors, in the District of Columbia and in Baltimore, his visits would be as frequent as three to four times a month. The usual length of each visit was a full day, sometimes longer. Contacts were generally with the distributor's general manager, plus sometimes the sales manager, wholesale manager, used-car sales manager, or on accounting matters, with the office manager. The district manager reported to the assistant general sales manager in Detroit and consulted with department heads in the Detroit sales office, such as the organization manager, business management manager, merchandising manager and used-car manager.

[fol. 419] (E) No new distributor was appointed in the "Washington district" during the six years that Mr. Davis was district manager in the territory. There were, however,

several new dealers, all of which were outside the District of Columbia. When a distributor's selling agreement expires or is modified for any reason and a new agreement is executed, the "tip-in sheet" (copy attached as part of Exhibit 1-A) is signed in Detroit by the general sales manager and assistant general sales manager. The district manager may sign the tip-in sheet as a witness to the distributor's signature which is ordinarily affixed at the distributor's place of business. The district manager then leaves a copy of the agreement with the distributor and returns a copy to Detroit.

(F) The basic function of the district manager is to assist the distributors, and through them the dealers, in running an efficient operation. The distributors, sometimes consulting with the district manager, prepare various sales forecasts which are sent to Detroit. Dealers submit sales forecasts and 10-day reports of sales and inventories to their distributor who consolidates them with a similar report on his retail operation. The distributor then mails the consolidated report directly to Detroit with a copy to the district manager. Monthly financial statements are mailed to Detroit by all distributors and by those dealers whose primary business management contact is with Cadillac. Most Cadillac dealers are "dualed," i.e., sell another [fol. 420] line of automobiles, and since the other lines (Chevrolet, Oldsmobile, etc.) are ordinarily sold in higher volume than Cadillac, business management contact is ordinarily maintained by the Zone Office of the higher volume division. In such cases, financial statements are submitted to the other division but not to Cadillac. Each distributor and dealer also forwards a monthly "sales manpower" (statement of personnel employed as salesmen by dealers and distributors) report to Detroit, with a copy to the district manager. In the case of Cadillac, the Zone Office functions hereinabove described for Pontiac are functions of the distributor, assisted by Cadillac personnel as described in this paragraph 8.

(G) Dealers order automobiles from the distributors, who in turn order from Cadillac, mailing the orders directly to the factory in Detroit, Michigan. The district

manager is not responsible for picking up the distributor's orders and did not do so for the distributor in Washington, D. C. He may occasionally obtain orders from a distributor for special tools, promotional materials and training aids, which are ordinarily purchased from outside firms but billed through the distributor's open account with Cadillac. All automobile sales to the distributor in Washington, D. C., Capitol Cadillac-Oldsmobile Co., are made, as during 1957 and 1958, f.o.b. factory in Detroit. All cars were shipped directly to the distributor's place of business in Washington, D. C., until November 21, 1957. At the distributor's request, new car shipments have, since that date, been sent directly [fol. 421] to the distributor's dealers in Bethesda and in Alexandria as well as directly to the distributor in Washington. Regardless of destination, all sales are, as during 1957 and 1958, made directly to the distributor.

(H) The district manager receives from Detroit reports of new car registrations in his territory. These are discussed with the distributor, pointing out areas in which the distributor's dealers are failing to obtain their share of the market. The district manager may periodically review financial statements of the distributors and dealers at their places of business and point out weak spots such as an unwieldy used car inventory or other above average expenses. At the distributors request the district manager may occasionally participate in various sales meetings. The district manager does not normally call on dealers unless accompanied by a representative of the distributor. The purpose of these calls is to assist the distributor in counseling with the dealers in the same manner that the district manager counsels with the distributors. Both distributors and dealers are urged to send their salesmen and mechanics to attend classes at the training center at Fairfax, Virginia.

(I) The parts and service manager reports directly to the general service manager in Detroit. His territory is the same as that of the district manager, and he works under the direction of the district manager. Ordinarily, they do not travel or make their contacts together. The [fol. 422] parts and service manager counsels with the dis-

tributors and dealers on warranty claims, customer complaints and other service matters. He urges distributors and dealers to maintain an adequate and current inventory of parts and accessories.

(J) In early 1957, a meeting of all Cadillac distributors in Mr. Davis' territory was held in Washington, D. C. This meeting was attended by the general sales manager and the assistant general sales manager for Cadillac. Its purpose was to review Cadillac's previous year's performance in relation to price class nationally and locally and to discuss the outlook for the same for the current year. A similar meeting was held in 1958. In addition, the assistant general sales manager for Cadillac visited the "Washington district" several times each year on good-will calls. Other department heads of the sales organization in Detroit make irregular visits to distributors and dealers within the "Washington district."

9. *GMC Truck & Coach Division*

Truck and Truck Part Sales

(A) The sales organization of the GMC Truck & Coach Division operates through a system of "regions" and "zones" like the car divisions other than Cadillac. The Zone Office whose territory includes the District of Columbia is located in Silver Spring, Maryland. Throughout 1957 and 1958 this Zone Office was located in Philadelphia, Pennsylvania. It is responsible for trucks and truck parts only and has no connection of any kind with the coaches [fol. 423] manufactured by the same Division. The zone territory is the eastern half of Pennsylvania, southern New Jersey, Delaware, the District of Columbia, Maryland, part of West Virginia, and nearly all of Virginia. The zone organization consists of the zone manager, four district managers, two heavy-duty truck managers, three service representatives, one training school instructor, one zone service manager, one truck distributor, one assistant distributor, four stenographers, and an office manager who is shared with the New York zone and whose office is at Elizabeth, New Jersey. The zone is divided into four districts for light and medium trucks, and two districts for heavy-

duty trucks. Light and medium trucks are handled by all dealers, some of whom handle also heavy-duty trucks.

(B) As in 1957 and 1958 there is one GMC Truck dealer within the District of Columbia, General Truck Sales, Inc., who handles light, medium and heavy-duty trucks. This dealer is visited by a "heavy-duty truck manager" (corresponding to district manager as described for Pontiac), living in Annapolis, whose territory includes the District of Columbia, Virginia, Maryland, Delaware and part of Pennsylvania, in which there are 14 dealers. The heavy-duty truck manager visits the District dealer usually once a month, assisting him with advice on selling and dealership management. He assists the dealers and sometimes the dealers' customers in recommending specifications and [fol. 424] equipment for particular applications required by the dealers' customers. He maintains a record for each of his 14 dealers on a form to which are posted all orders received by the factory from dealers. When calling on the dealers he finds out which of the ordered vehicles have been sold, are in inventory, etc. Each month he turns in a form for each dealer, reporting data obtained by calling on the dealer. It shows the stock on hand, orders unfilled, used truck inventory, and comments on display of signs, housekeeping, accessories display, number of salesmen, participation in promotional activities and other matters. These are analyzed in the Zone Office and any resulting suggestions are passed back to the dealers, generally through the heavy-duty truck manager. In addition, the dealer mails in a 10-day report directly to the Zone Office showing the condition of his inventory. Although the selling agreement calls for it, the dealers do not submit 90-day forecasts. If the heavy-duty truck manager considers the dealer's inventory of trucks too small, he may urge him to place orders which are ordinarily mailed by the dealer to the Zone Office in Silver Spring. Very occasionally, he may pick up truck orders to be sent to the Zone Office. The heavy-duty truck manager does not press for orders for parts and accessories, but does solicit orders for items consumed by the dealers, rather than items sold by him; for example, special tools and advertising literature.

(C) The zone service manager is responsible for super-
[fol. 425] vising the service representatives and the training school instructor. He spends approximately 60% of his time calling on dealers in the entire zone; the remainder of his time is spent in the Zone Office. He calls on the District dealer on the average of once every two months. He may accompany the service representatives on some occasions to assist them in handling complaints, improving dealers' service functions, and advising on service techniques and special tools. Upon request, he expedites parts ordered by the dealer by calling the parts warehouse in Elizabeth, New Jersey, but does not check dealers' parts inventories. He may, however, advise on the initial stock order for a new dealer.

(D) One service representative travels to visit about 60 dealers, including the dealer in the District of Columbia, in a territory which includes, in addition to the District, most of Virginia, parts of Maryland, and West Virginia. He calls on the District dealer on the average of once a month, usually visiting the dealer's service manager and occasionally the general manager. He checks to see that exchange parts are turned in and that the defective parts are actually scrapped. The service representative reports on product failures to the engineering department at the factory, and prepares warranty reimbursement authorizations. He reports also on any deficiencies observed in dealer service operations, passes on suggestions for their correction, and follows up on complaints received at the factory. He also calls on fleet operators who do their own
[fol. 426] service work, as for example in the District of Columbia Hertz (truck rental) and Hecht (department store delivery fleet). There is a large number of such customers, of whom some three or four are in the District. He sees them from as often as once a month to as seldom as twice a year. This contact is for public relations and to give technical advice and to induce the customers to take advantage of the training schools for service men. He urges the dealerships to order special tools, which are supplied by an outside organization but are charged through the dealer's parts accounts.

(E) All truck orders are sent by the dealers to the Zone Office in Silver Spring and by the Zone Office to the factory at Pontiac, Michigan. The heavy-duty truck managers or district managers may occasionally pick up truck orders to be sent to the Zone Office. Shipments are f.o.b. the factory, Pontiac, Michigan, direct to the dealer. They are invoiced from the factory and invoices are paid to the factory. Dealers mail parts and accessories orders directly to a parts warehouse in Elizabeth, New Jersey, where they are billed by shipment f.o.b. warehouse. The dealer may finance his truck purchases through Yellow Manufacturing Acceptance Corporation (a General Motors wholly-owned subsidiary), in which case security title is passed to YMAC at the factory. Some dealers use other financing methods or pay cash, in which case shipments are on bill of lading with sight draft attached.

(F) Dealer meetings conducted by Division personnel are [fol. 427] held from time to time at various places in the area, at the training center in Fairfax, Virginia, or occasionally in a Washington hotel. No contracts are handled at such meetings, the usual purpose of which is for Division personnel to discuss new models and related matters, such as sales promotion materials. There are also smaller meetings for limited areas at which programs for familiarizing dealers' salesmen with selling points or product information are presented by Division personnel. Some of these are held in the training center in Fairfax, Virginia, and others at the dealers' places of business (remote from Fairfax and outside the District) or at other selected points within the zone outside the District. Dealers, their sales managers, and perhaps their salesmen are invited to all such meetings. Dealers (including the District dealer) send their salesmen to sales training classes held at the training center in Fairfax, Virginia. The Zone Office has no contact with sales to the United States Government.

(G) General Truck Sales, Inc., was the only GMC Truck dealer in the District during 1957 and 1958. This dealer was appointed in June 1952, and no new dealers have been appointed in the District since that date.

Coach and Coach Part Sales

(H) The Zone Office maintained by the GMC Truck & Coach Division in Silver Spring, Maryland, has nothing to [fol. 428] do with the coach and coach part sales made by that Division. Coach sales are solicited and promoted by district representatives who are located in various parts of the country. Mr. W. Ralph Davis is, as during 1957 and 1958, district representative for a territory which includes the District of Columbia and most of Virginia and Maryland. He reports to the assistant general sales manager in charge of coach sales at the factory in Pontiac, Michigan. Mr. Davis' home is in Alexandria, Virginia, and he uses it as his business headquarters. His name, home address and telephone number appear on a GMC Truck & Coach Division letterhead. He is not reimbursed for any expenses of his home, except for charges for long distance telephone calls. Neither Mr. Davis nor GMC Truck & Coach Division maintains any office within the District of Columbia.

(I) In 1957 and 1958, Mr. Davis contacted four customers within the District of Columbia: D. C. Transit, Gray Line, Safeway Trails and Trailways of New England. He spent 15%-20% of his time in the District during 1957 and 1958, but this varies depending upon customer requirements. His activities included the solicitation and promotion of coach sales to the foregoing District customers. D. C. Transit specifications are so detailed that quotations are prepared at the factory in Pontiac, Michigan, and delivered by Mr. Davis in Washington, D. C. Mr. Davis makes quotations to the other District customers on the basis of prices, terms and conditions established by the factory. Orders [fol. 429] are ordinarily signed on behalf of the customer at his office and then signed by Mr. Davis, subject to acceptance or rejection at Pontiac, Michigan, by the divisional general sales manager. Coaches are made to order and are not stocked. Deliveries are made f.o.b. factory and shipped by common carrier into the District of Columbia except that Gray Line picks up coaches at the factory. Payments are made in cash, usually through a conditional sales contract which is sold to a bank or finance company.

(J) A parts representative, living in New York, works out of a parts warehouse located in Elizabeth, New Jersey. He contacts customers including those in the District and advises them on maintaining an adequate inventory of parts and other related matters. Customers are supplied with parts catalogs and ordinarily mail parts orders directly to the New Jersey warehouse. Billings are made from the warehouse, and sales are ordinarily made an open account but sometimes on a c.o.d. basis. Emergency orders are placed by telephone or telegram. Occasionally the parts representative might pick up an order for parts.

(K) A service representative, living in Maryland, contacts the customers in the District of Columbia. At one time, he covered the same territory as does Mr. Davis, but at present there are three service representatives in this territory. The service representative advises on service problems and is particularly active when a customer is experiencing some unusual difficulty with a new model coach [fol. 430] or bus. Technical and engineering personnel from the factory in Pontiac, Michigan, visit customers when new models give trouble and require attention beyond that provided by the service representative. Ordinarily there are no visits to customers by other sales or management personnel.

10. *Relationship Between Petitioner and Its Car and Truck Dealers.*

(A) Petitioner and its car and truck dealers have entered into "Dealer Selling Agreements" which are in all material respects uniform. Typical dealer selling agreements are attached as Exhibits 2-B and 3-C. As during 1957 and 1958, all of Petitioner's car and truck dealers in the District of Columbia are operating under such agreements and are corporations which own and operate retail outlets for the sale and service of Petitioner's products. Respondent reserves the right to argue that the relationship between Petitioner and the four dealerships operating under the Motors Holding plan described in paragraph 20 hereof was such to constitute Petitioner a participant in such dealer-

ships; and nothing in the preceding sentence is intended to prejudice Respondent's position with which Petitioner disagrees. The dealership's facilities—land, buildings, etc.—are owned by it or leased from others. It owns its tools, equipment, supplies, signs, etc., its inventory of parts and accessories and its inventory of new and used cars and, in the case of new cars, usually subject to financing arrangements with a bank or finance company (frequently including General Motors Acceptance Corporation and Yellow [fol. 431] Manufacturing Acceptance Corporation). The dealership sets the price and terms and conditions of resale. It takes used cars in trade which it either wholesales or retails from its used-car lot. It stocks parts and accessories and operates a garage to provide satisfactory service for its customers. Subject to the above reservation, the dealer corporation, as owner and operator of the business, is responsible for its over-all activity and its success, and in the event of failure, it suffers the loss.

(B) Petitioner and its Cadillac distributors have likewise entered into "Distributor Selling Agreements," a copy of which is attached as Exhibit 1-A. This is similar to the "Dealer Selling Agreements" except that it constitutes the distributor a wholesaler with the function of appointing and selling to dealers as well as making sales to retail customers, all as described in paragraph 8 hereof. As during 1957 and 1958, the Cadillac distributor in Washington, D. C. is incorporated.

(C) A General Motors dealer or distributor may terminate its selling agreement with or without cause on thirty-days' notice; on the other hand, Petitioner may terminate the selling agreement only for the specific causes stated therein. (See Exhibits 1-A, 2-B and 3-C)

(D) The co-operative advertising program referred to in the selling agreements, Exhibits 1-A, 2-B and 3-C, was discontinued prior to the taxable years. Estimated expenditures by Petitioner for national and local advertising of all kinds for the promotion of the sales of Petitioner's products [fol. 432] including magazines, newspapers, radio and television having a circulation in or directed to or emanating

within the District of Columbia, aggregated $144,000,000 in 1957 and $137,000,000 in 1958.

(E) A field representative of the Dealer Business Management Department of the General Motors Central Office in Detroit approximately twice a year conducts an examination of the books and records of the Washington car and truck dealers (other than the dealers being financed under the Motors Holding plan) and the Cadillac distributor to determine whether such books and records conform to the standard accounting system required by the selling agreements. A similar but more extensive examination of the books and records of dealers financed under the Motors Holding plan is conducted every three months by Petitioner's Motors Holding Division. Zone personnel may occasionally check pertinent portions of a dealer's books and records when such dealer is asserting a claim against Petitioner, for example, claims for reimbursement for warranty adjustments and for wholesale parts compensation.

(F) Petitioner does not take physical inventories of the automobiles, parts and accessories carried in stock by its car and truck dealers or Cadillac distributors.

(G) Automobiles and trucks are sold only to authorized dealers and distributors except that some automobiles and trucks are sold direct to Petitioner's employes, foreign diplomats, the United States Government, the American [fol. 433] Red Cross, to retail customers through a small number of factory branch dealerships (none of which is in or near the District of Columbia) and (throughout 1957 and until May 1958) to some political subdivisions such as cities, states, port authorities, etc.

(H) Automobile and truck parts and accessories are sold only to authorized dealers and distributors, except that such items are sold direct to Petitioner's employes, the United States Government, to end-product manufacturers for incorporation into their products and to retail customers through a small number of factory branch dealerships (none of which is in or near the District of Columbia).

Sales of Standard Motor Vehicles to the United States Government

11. *Government Sales Section*.

(A) The Government Sales Section of the General Motors Corporation Central Office is headquartered in Detroit. Its function is the obtaining, receiving and servicing of invitations to bid on requirements for standard passenger cars and trucks of all federal government agencies, military and civilian. In 1957 and 1958, the Government Sales Section was responsible for conducting liaison activities related to the procurement of special military vehicles for the armed services; however, such activities are now assigned to the Defense Systems Division. The Zone Offices of the car and truck divisions, heretofore described, had no connection with any of the foregoing sales.

[fol. 434] (B) The Section maintains a Washington office, normally staffed by two contact men, three girl clerk-stenographers and one chauffeur. The contact men call on procurement agencies, including purchasing agents, specification writers, etc. Their function is to find out what buying plans there are and to see that the office in Detroit is included on lists of suppliers to whom invitations to bid are sent. The government personnel contacted by these men are in the District and in various offices, testing grounds and other installations within three hundred miles of the District. In addition to the two contact men permanently stationed in the District of Columbia, the director of the Government Sales Section, whose headquarters are in Detroit, spends up to half his time in Washington talking with government officials about procurement as it involves standard motor vehicles.

(C) Invitations to bid on motor vehicle requirements are received and processed at the Detroit office of the Government Sales Section. The invitations to bid are mailed by the government agencies directly to Detroit; however, on rare occasions a representative from the Washington office of the Government Sales Section will pick up extra copies of the invitation mailed to Detroit when more than one of Petitioner's divisions was planning to bid. The invitations

are then forwarded to the manufacturing division involved which prepares a bid proposal. In all cases, the bids are signed on behalf of Petitioner in Michigan. Bids in response [fol. 435] to invitations to bid from the General Services Administration are mailed to the Administration's Washington office. In the event that Petitioner's bid is accepted, the contract is signed in Michigan on behalf of the Petitioner and in Washington on behalf of the General Services Administration. Bids in response to invitations to bid on standard motor vehicles for the Armed Services are sent to the Detroit office of the Ordnance Tank Automotive Command (OTAC). If Petitioner's bid is accepted, the contract is signed in Michigan on behalf of Petitioner and on behalf of the Armed Services at the Detroit OTAC office. No orders for such vehicles are solicited in Washington. Automobiles and trucks purchased from Chevrolet for use in the District of Columbia are generally shipped by Chevrolet into the District from its factory in Baltimore by private carrier. Almost all other deliveries are to points outside the District. No deliveries originate in the District. Cadillac rents approximately 31 automobiles to the White House and other top level offices in the District of Columbia. Some of these cars are serviced by their users at their own expense, but on some of them service is included in the rental. Such cars are taken by their users to dealers, who render the service and bill Cadillac.

Activities of Certain Offices Within the District of Columbia

12. *AC Spark Plug Division*

(A) Petitioner's AC Spark Plug Division has its head- [fol. 436] quarters at Flint, Michigan. It is engaged, at its Flint plant, in the production of spark plugs, speedometers, fuel pumps, oil filters, air cleaners and other automobile equipment. This Division also maintains a plant in Milwaukee, Wisconsin, which is engaged almost exclusively in the production of defense materials, such as guidance systems for missiles and aircraft weapons, bombing navigational computers, and gun-bomb-rocket sights.

(B) AC Spark Plug Division has an office in the District of Columbia known as the Eastern Region to which are assigned a manager, a sales engineer, and two stenographers. Mr. Robert H. Wilkie is the manager in charge of the District of Columbia office. Ninety-eight per cent of the activities of the District of Columbia office is related to the Milwaukee, Wisconsin plant of AC Spark Plug Division which is engaged almost exclusively in the manufacture of defense materials. The remaining two per cent of these activities pertains to materials produced at Flint, Michigan, which are applicable to the defense production of the Milwaukee plant. The District office is under the direction of and reports to the directors of sales at Milwaukee. Mr. Wilkie's duties as manager include supervising all activities in the Eastern Region. The activities involved are of a highly technical nature, and all personnel in the District of Columbia office, except clerical personnel, are graduate engineers. This office was not used in connection with the [fol. 437] non-government sales of AC Spark Plug Division described in paragraph 17 hereof.

(C) The Eastern Region includes that part of the United States east of Ohio. In addition to the District of Columbia office, the Eastern Region includes an office in Boston, Massachusetts, with personnel consisting of one sales engineer and one stenographer. The Boston office is under supervision of the manager of the Eastern Region, Mr. Wilkie.

(D) The District of Columbia office maintains contact with military and civilian agencies concerned with defense materials, and in addition, with primary contractors dealing with defense materials. Mr. Wilkie has no authority to sign contracts on behalf of Petitioner. All contracts in excess of $100,000 are signed in Detroit, Michigan, on behalf of Petitioner. Contracts of less than $100,000 are signed in Flint, Michigan, or in Milwaukee, Wisconsin, on behalf of Petitioner. Contracts are signed on behalf of the purchaser at the purchaser's office which, in the case of a direct sale to the United States Government, may include the Washington office of the procuring agency. The duties of the District of Columbia office may be characterized primarily as liaison. These duties consist of de-

termining the nature of the planning of the various government agencies and advising AC Spark Plug Division of the necessary engineering to be undertaken thereto, as well as informing the various government agencies of the capabilities of the Division.

[fol. 438] (E) When a procurement contract appears imminent, the regional manager advises the Milwaukee office and a team of engineers is sent to the government agencies involved for the purpose of making a detailed technical presentation. This is followed by a request by the government agency involved for a contract proposal from the Milwaukee office. After preparation, the proposal is delivered by the regional office to the government agency involved. Provision is made in such proposal that questions regarding specifications and prices should be directed to the Milwaukee office. Subsequent communications are generally conducted between the government agency and an individual in the Milwaukee office. The regional office, however, participates to the extent of expediting performance and conducting negotiations regarding some details of the contracts. A contract resulting from the aforesaid negotiations is signed as indicated in subparagraph (B) above. After the contract is entered into, participation of the District of Columbia office is limited to providing two-way contact in connection with difficulties of administration.

13. *Allison Division*

(A) Petitioner's Allison Division has its headquarters and main plant at Indianapolis, Indiana. It has another plant at Vandalia, Ohio. Among its civilian products are prop-jet engines for commercial aircraft; transmissions for trucks, heavy-duty vehicles and rail cars; and gas turbine engines for heavy-duty construction equipment. For [fol. 439] defense purposes, Allison Division manufactures prop-jet and turbo-jet aircraft engines; aircraft propellers; transmissions and power trains for tanks and other heavy ordnance tactical vehicles; and bearings for aircraft, tank engines and tank transmissions.

(B) Allison Division maintains, as during 1957 and 1958, an office in Washington, D. C., which, although called a Zone Office, should not be confused with the zone offices of the car and truck divisions. The Allison Washington office provides two-way contact between the federal government and prime contractors for defense materials on the one hand and the divisional headquarters on the other. The zone territory is roughly the East Coast. In addition to the zone manager, the zone personnel consists of a zone service manager, 19 service representatives and three field engineers, plus clerks and stenographers, for a total personnel of approximately 25. The 19 service representatives are scattered around the zone, including four in a New York branch office and others in Annapolis, at Langley Field, three in Washington, and others at other locations.

(C) The three field engineers, stationed in the Washington office, are assigned directly to the military services, one each for Army, Air Force and Navy. The field engineers obtain information leading to competitive business from the Armed Services or prime contractors. Their principal function is to find out what developments the Services [fol. 440] are contemplating in order that the engineering staff at division headquarters in Indianapolis can undertake studies of the feasibility of developing an Allison engine, propeller or other product to meet the requirement.

(D) Zone personnel also work with prime contractors in the zone territory for the incorporation of Allison products. A current example is the Navy's Hydrofoil program. The development of thinking in the Bureau of Ships on this project was followed for a year or more with the idea of adapting an aircraft turbine engine to power the ship. When it appeared that Martin and others would be considered as prime contractors, engineers from the Indianapolis headquarters were brought into the area to discuss with Martin and the Navy what the requirements would be and assisted in the development of a bid request. Allison will try to submit a proposal for an engine and a transmission, or for a transmission alone if some other make of engine is selected.

(E) None of the prime contractors is located in the District of Columbia. Original equipment is ordinarily sold entirely to them. If, as in some cases, the power plant for an aircraft or boat is to be government furnished to the contractor by competitive bidding, negotiations are carried on directly between the government cc tracting officer and some Allison official at Indianapolis. T Allison Washington office would carry on any necessa liaison activity. The Zone Office has very little contact v h direct [fol. 441] government purchases of spares, none of which are shipped into the District.

(F) Although most of the concern of the Washington office is with defense equipment, it is interested in some commercial projects, viz.: At the moment, it is attempting to sell the Allison conversion of Convair airplanes to the Federal Aeronautics Administration for its five test planes; it also attempts to sell engines to manufacturers of commercial planes, none of whom are in the District; and a current research project undertaken for a government agency is being performed in Indianapolis and will result in the delivery of a report to the agency in Washington.

(G) Contracts are signed on behalf of Petitioner's Allison Division at Indianapolis, Indiana, and on behalf of the purchaser at the purchaser's office, which in the case of some direct government purchases may be in Washington. A current form of activity is team procurement, that is, the government in a single contract employs various contractors, including Allison, on a joint project to which Allison contributes engines or other components and other manufacturers contribute other parts of the assembled product.

(H) Regular visits to the zone, including some to Washington by personnel from Indianapolis, average approximately 80 a month. Most of the visitors are engineers, discussing technical details with the government agencies or with prime contractors; however, visits by the sales [fol. 442] staff are also frequent, to discuss such aspects as delivery schedules, costs, etc.

14. *Cleveland Diesel Engine Division*

(A) Petitioner's Cleveland Diesel Engine Division has its headquarters and plant in Cleveland, Ohio. Its principal products are diesel engines for commercial, marine and industrial uses and gas and dual fuel engines for industrial uses. Sales to the United States Government include diesel propulsion machinery for naval vessels, diesel engine generator sets and vapor compressors for water distilling units.

(B) Cleveland Diesel maintains, as during 1957 and 1958, an office in Washington, D. C., which is staffed by a manager and his secretary. The function of this office is providing a convenient point for two-way contact rather than sales. The manager keeps in touch with various government agencies, such as the Corps of Engineers and the Bureau of Ships, some of which are in the District of Columbia. Quotations are all made in Cleveland and sent to him for delivery. He has no contact with any sales for commercial purposes. Occasionally a passing commercial ship will call seeking service help. All these calls are merely referred to dealers, none of whom is located in the District, or to another Cleveland Diesel office. Occasional government calls for emergency parts are also expedited.

(C) Typical instances of the manager's duties are a day [fol. 443] in which he called on the Legal Section of the Bureau of Ships to discuss a three-year-old contract snarl at Newport News, and delivered to that office technical information requested the day before for a new program. Another day was spent partly on working on files in the office and partly visiting the Bureau of Ships at its request to learn about a new program. That was followed up by requesting information from the Cleveland headquarters.

(D) Procurement procedure is typically as follows: If the aforementioned program is eventually adopted by the Navy, the next step will be negotiation of specifications, including such matters as adapting the exterior dimensions of an engine to fit the space available, or providing for ship space to accommodate existing engine dimensions. This

work is done by engineers from Cleveland at home and in the Bureau of Ships' headquarters in Washington. If a given make of engine is the only acceptable one, the Navy buys accordingly. If more than one can qualify, invitations to bid are sent to all (usually there are only two), in the case of Cleveland Diesel direct to Cleveland. The bid is prepared in Cleveland and sent to the manager for delivery. After the bid is delivered, he negotiates details of the contract with respect to particular clauses, and works out changes in the bid if required. The contract is then sent by the Bureau of Ships direct to Cleveland for approval and signature. The manager is active during the negotiation [fol. 444] period, but has little contact thereafter.

(E) Contracts are signed in Cleveland, Ohio, on behalf of Petitioner. Contracts are signed on behalf of the United States Government at the office of the procuring agency which, in some cases, is located in Washington, D. C. The manager of the Washington office in Cleveland Diesel Engine Division has no authority to sign contracts on behalf of Petitioner. All products are manufactured in Cleveland and are shipped f.o.b. factory Cleveland.

15. *Detroit Diesel Engine Division*

(A) Petitioner's Detroit Diesel Engine Division, with its headquarters in Detroit, Michigan, manufactures diesel engines singly or in multiple combinations up to 1200 horsepower for universal application. It also manufactures for defense purposes auxiliary generator sets for tanks and other armored vehicles, marine propulsion and auxiliary engines and portable engine generator sets. Its manufacturing plants are located in Detroit and Wayne, Michigan.

(B) Detroit Diesel maintains within the District of Columbia a government liaison office which is ordinarily staffed by a manager and his secretary. At present, the office also includes a part-time consultant who, until recently, was the manager of the office. The sole function of this office is to provide two-way contact related to the procurement of diesel engines and other products by various [fol. 445] offices of the United States Government. All com-

mercial business is handled through independent distributors, whose contact is with a regional office in New York. The nearest distributor is in Baltimore, and neither he nor any other distributor has any contact with the office in the District, with the exception that an occasional request from a government agency for one or two engines will be referred to a distributor, and with the further exception that occasionally a distributor may ask for certain technical information which is provided as an accommodation. Occasionally, the masters of visiting yachts call on the office for service and are referred to distributors.

(C) The personnel headquartered in the District of Columbia office travel widely, covering government installations, looking for leads to applications for which Detroit Diesel engines may be recommended. These government requirements may originate anywhere, but most of them are "coordinated" through the Washington headquarters of the government service involved. If, for example, a government agency is buying certain vehicles, the branch office will attempt to have Detroit Diesel engines specified or to have specifications written which Detroit Diesel can meet, and then pass the information along to Division headquarters in Detroit to apprise it on the opportunity to sell the engines to the vehicle manufacturer.

(D) A slightly different but related activity is working [fol. 446] on specifications with the Bureau of Public Roads in the District of Columbia and other government organizations involved in foreign assistance programs to have specifications so developed that Foreign Distributors Division can bid for the use of Detroit Diesel engines, or so that a domestic vehicle manufacturer is able to meet specifications with a product which includes Detroit Diesel engines.

(E) The personnel stationed in the Washington office of Detroit Diesel Engine Division have no authority to sign contracts on behalf of Petitioner. Contracts are signed on behalf of Petitioner at Division headquarters in Detroit, Michigan. Contracts are then signed on behalf of the Government agency involved at its office, including offices in Washington, D. C. The Detroit Diesel non-government sales

for 1957 and 1958 in which the goods were shipped into the District of Columbia were made pursuant to a contract negotiated entirely outside the District of Columbia between Detroit Diesel and a customer. There was no activity in the District in connection with this contract. The goods were shipped from Detroit on order from the customer to points within the District of Columbia.

Other Sales by Petitioner's Divisions

16. *United Motors Service Division*

(A) Petitioner's United Motors Service Division is responsible for the top level wholesale distribution of certain [fol. 447] parts and accessories manufactured by Petitioner (or in a few rare instances by others) and used in connection with Petitioner's products. The customers of this Division are wholesalers, which term is defined to include organizations whose business is 85 per cent or more the wholesaling of automotive replacement parts.

(B) The Division's sales organization is centered in Detroit, Michigan. Its lowest administrative office is the zone office. The zone office for this area was located in Washington, D. C., during 1957 through June 30, 1958, at which time it was removed to its present location in Silver Spring, Maryland. The zone manager reports to a regional manager in Atlanta who in turn reports to an assistant general sales manager in New York who in turn reports to the general sales manager in Detroit. The zone territory covers Delaware, Eastern Maryland, District of Columbia, Eastern Virginia, eight counties in Eastern North Carolina and three counties in West Virginia. The territory is divided into six districts each of which was served by a district manager reporting to the Zone Office. The district manager whose territory includes the District of Columbia also covers five counties in Maryland and two counties in Virginia. During 1957 and 1958, he resided in Silver Spring, Maryland.

(C) There are 22 people in the Zone Office. The only person (other than the merchandising representative men- [fol. 448] tioned in (E)) making regular contacts in the Dis-

trict is the district manager who in 1957 and 1958 had 17 customers within the District and 13 outside. He sold merchandising items such as display stands, promotional giveaways and advertising materials. He presented merchandising programs to his customers including educational talks such as new product descriptions. Merchandising programs were presented first to the customer management and, if approved, later to salesmen. They included display cases, catalogues, and advertising materials. The district manager urged wholesalers to maintain adequate stocks and occasionally would call on wholesalers not carrying United Motors Service lines to check for possible new outlets. The district manager also sometimes accompanies the wholesaler in making contacts with the wholesaler's customers which would include retail dealers of all kinds such as automobile dealers, service stations, etc. Other Zone personnel infrequently accompany the district manager.

(D) The wholesalers are provided with printed order forms which they mail to a United Motors Service warehouse in Philadelphia. Shipments are made directly to the wholesalers from this warehouse or, in the case of heavy items (e.g., batteries) directly from the factory. At present, customers are provided with direct shipment order forms which are mailed to the Philadelphia warehouse for processing through to the appropriate factory on items other than batteries, such as Delco Superide and Super- [fol. 449] lift Shock Absorbers, Delco Electronic Receiving Tubes, Rochester Carburetors and Parts, Harrison Thermostats, etc. All sales are, as during 1957 and 1958, made an open account, and title passes at the point of shipment, except that sales to bad credit risks may be made on a cash with order or c.o.d. basis. No sales are made on consignment, and all stock in the hands of customers is owned by them.

(E) The Zone Office has seven merchandising representatives who travel with salesmen of the wholesalers calling on retailers. They are not assigned specific territories but work where needed. Approximately 15% of their time is spent in the Washington metropolitan area which includes the District, Montgomery and Prince Georges counties in Maryland and Fairfax and Alexandria counties in Vir-

ginia. They put up signs and displays, pass out product information and urge retailers to order from the wholesalers. They do not carry order pads and do not write orders to be placed with the wholesalers.

(F) The zone service manager handles service problems with manufacturers, users and distributors. He instructs wholesalers on handling warranty claims but does not adjust such claims. He sometimes assists wholesalers and retailers in settling the complaints of ultimate users. He urges wholesalers to send salesmen and service personnel to the General Motors Training Center at Fairfax, [fol. 450] Virginia, where all instruction and materials are furnished free. When service campaigns are necessary to correct a general defect, he passes them on to wholesalers, urging them to follow up and see that the service is rendered. He gives technical instruction, if required, to wholesaler's service departments.

(G) The arrangement between United Motors Service Division and the wholesaler is formalized in a short written agreement, a copy of which is attached as Exhibit 4-D. The customer is usually one already well established in business when United Motors Service lines are first offered to him. The need for a wholesaler in a given territory is determined by the district manager and the zone manager on the basis of car registrations. The zone manager investigates potential customers for credit and business standing before making the appointment. Sometimes an existing wholesaler makes the approach to United Motors Service and sometimes United Motors Service initiates the approach. Appointments are approved by the regional manager and then signed by the zone manager in his office and mailed to the wholesaler. The zone manager inspects the place of business before making any recommendation for an appointment. The wholesaler is an independent businessman, who sells on his own account at his own risk.

17. *AC Spark Plug Division (Civilian Sales)*

(A) The headquarters and civilian production of Peti- [fol. 451] tioner's AC Spark Plug Division are centered in

Flint, Michigan. At its Flint plant, AC Spark Plug manufactures automotive parts such as spark plugs, oil filters and elements, fuel pumps, speedometer cable, air cleaners and elements and hydraulic valve lifters. AC Spark Plug sells these parts and others principally to two types of customers: (1) warehouse distributors, which term is defined as an organization whose business is 90% or more the wholesaling of automotive replacement parts, including AC and competing lines, and (2) national accounts, which term includes oil and tire companies which engage in the wholesaling of automotive replacement parts.

(B) The sales organization of AC Spark Plug is headquartered in Flint and is directed by the general sales manager. Its lowest administrative office is the regional office. The Regional Office for Region 5, whose territory includes the District of Columbia, has been located in Bala Cynwyd, Pennsylvania since 1956, and from 1938 until then, it was located in Philadelphia, Pennsylvania. The regional manager reports to the eastern sales manager, whose office is also in Bala Cynwyd. AC Spark Plug maintained no offices within the District of Columbia during 1957 and 1958 except for the government liaison office described in paragraph 12 hereof.

(C) In addition to the District of Columbia, Region 5 includes part of New York, central and eastern Pennsyl- [fol. 452] vania, Delaware, most of Maryland and Virginia, one town in West Virginia and three towns in North Carolina. There are approximately 40 personnel working from the Regional Office, including a regional manager, three zone managers, one fleet sales and service representative, two national accounts representatives, one national account territory manager, fifteen territory managers, thirteen dealer merchandisers, an office manager and four clerk-stenographers.

(D) The region is divided into zones, but there are no zone offices. Zone 2 includes the District of Columbia, most of Virginia and Maryland, three towns in North Carolina and one town in West Virginia. The zone manager in charge of Zone 2 lives in Deale, Maryland. His principal duties

are the training and supervision of five territory managers and five dealer merchandisers who work the territory of Zone 2. One territory manager and one dealer merchandiser are assigned to the part of the zone which includes the District of Columbia. The zone manager spends most of his time traveling with the territory managers and dealer merchandisers when they make their calls, observing their work and giving them help and supervision. He does this with each man and covers the entire zone. The length of time the zone manager spends with a particular territory manager or dealer merchandiser depends upon the experience and caliber of the man, his problems and needs. He also calls on various government agencies, some of which [fol. 453] are in the District, such as the General Services Administration and the Post Office, to obtain business. The zone manager spends approximately 5% of his time in the District of Columbia.

(E) One territory manager covers and makes regular calls within the District of Columbia, occasionally accompanied by the zone manager. The territory manager contacts the warehouse distributors. There are seven warehouse distributors in the District of Columbia (six in 1957 and 1958), and in addition a Philadelphia warehouse distributor maintains two branch outlets in the District of Columbia and a Baltimore warehouse distributor maintains one branch outlet. The territory manager contacts the District warehouse distributors on the average of once every six weeks, and the zone manager contacts them on the average of twice a year. The territory manager, on his calls, promotes the sale of AC lines, conducts sales meetings for the warehouse distributor's salesmen, promotes sales contests for the warehouse distributor's salesmen, and sets up displays and merchandising programs. He informs the warehouse distributors of what items are moving fast or slow so that inventories can be kept at the proper level. The territory manager physically checked the inventory once every three months of one of the six warehouse distributors in the District of Columbia in 1957 and 1958; but this was not necessary for the other five because they maintain adequate inventory control systems. The District of Columbia warehouse distributors [fol. 454] ordinarily prepare their own orders, which are

sometimes checked by the territory manager. On infrequent occasions, the territory manager may solicit orders from the warehouse distributors, and he may pick up orders for mailing to the factory at Flint. In addition to calling on the warehouse distributors, the territory manager calls on "jobbers" and "jobber fleet operators" (large fleet users such as Hertz) in the District of Columbia who buy from the warehouse distributors. The territory manager also calls on "dealers" (service stations, garages, etc.) and "fleets" (small fleet users such as laundries, etc.) in the District of Columbia. He solicits orders from the jobbers, jobber fleet operators, fleets and dealers, which in many cases he writes up, and places the order with the jobber or the warehouse distributor of their choice, a copy of this order form is attached as Exhibit 5-E. The territory manager also calls on the national accounts and those who purchase from them. In 1957, there were none of the national accounts with offices within the District of Columbia, and in 1958 there was one with an office in the District of Columbia. AC makes no shipments within the District of Columbia to national accounts; all such shipments to national accounts with offices in the District of Columbia are made to points outside the District pursuant to orders placed by them from offices outside the District. The territory manager covering the District of Columbia spends approximately 20% of his time in the District.

[fol. 455] (F) Each warehouse distributor, including those in the District of Columbia, places a monthly order on an order pad which is mailed each month from Flint directly to the warehouse distributor (copy attached as Exhibit 6-F). The territory manager, and less likely the zone manager, may assist in the preparation of this order. It is ordinarily mailed by the warehouse distributor direct to Flint, although the territory manager may do this. Sales pursuant to this order are billed on a deferred 30 day basis; for example, a March order, billed April 1, payable May 10. All shipments are f.o.b. Flint by common carrier with title passing at Flint. The warehouse distributor also places supplementary or special orders, on his own forms, in addition to the monthly order. These orders likewise may be promoted by the territory manager.

(G) The dealer merchandisers are not responsible for calling on the warehouse distributors, jobbers or jobber fleet operators. They are missionary men calling on the lowest distribution level, i.e., the dealers (service stations and garages, etc.) and the small fleet operators (laundries, bakir companies, etc.). They solicit and write orders (co order form attached as Exhibit 5-E) from these establishments, which are placed with the jobber or warehouse distributor of the buyer's choice. The dealer merchandiser whose territory includes the District of Columbia spends approximately fifteen days a year in the District [fol. 456] of Columbia.

(H) The regional manager makes business calls in the District of Columbia approximately twice a year, and the eastern sales manager makes such calls approximately once a year. A service representative, now living in New Jersey and reporting directly to Flint, covers the eastern part of the United States, and goes where needed to handle service problems, which sometimes includes the District of Columbia. A national accounts representative, who covers the entire region and now lives in Pennsylvania, makes business visits to the District of Columbia approximately once a year. A fleet sales and service representative reporting to the regional manager, covers the entire region and infrequently, perhaps once a year, calls on jobber fleet operators and fleet operators in the District of Columbia.

(I) The arrangement between AC Spark Plug Division and a warehouse distributor is set forth in a short written agreement (copy attached as Exhibit 7-G). All of the six warehouse distributors in the District of Columbia in 1957 and 1958 were appointed prior to 1957.

Activities of Administrative (Non-sales) Offices Within the District of Columbia

18. *Business Research Staff*

The Business Research Staff had an office in Washington from 1952 through 1958. Ludwig Hellborn was manager throughout. Part of the time the office consisted of himself [fol. 457] and his secretary, and part of the time he had one

assistant. The Business Research Staff is headquartered in Detroit and has the function of economic and statistical research to forecast general economic conditions and their effects on products and possible product changes to be developed and manufactured by Petitioner. Mr. Hellborn carried out part of that function, principally in the gathering of information from governmental offices in the District of Columbia and elsewhere such as the Bureau of Census, the Bureau of Foreign and Domestic Commerce, the Office of Statistical Standards, the Bureau of Labor Statistics, the Council of Economic Advisers, the Board of Governors of the Federal Reserve System, and also such private agencies as the United States Chamber of Commerce and Brookings Institution. Information requested or required of the Petitioner was supplied through the office to various governmental agencies in the District of Columbia and elsewhere, as for example the Bureau of Census. A minor part of the job was contact with regulatory bureaus on matters affecting Petitioner, and some contact also with professional staffs of Congressional committees.

19. *General Motors Overseas Operations Division*

General Motors Overseas Operations Division, headquartered in New York, maintains an office in the District of Columbia, staffed by a manager, an assistant manager and a secretary. This office has no sales responsibility. Except for direct sales to General Motors plants overseas and [fol. 458] the sales of locomotives and Euclid equipment, the sales of General Motors products for use overseas are handled by Petitioner's Foreign Distributors Division which has no office within the District of Columbia. The office has no routine assignments, being kept free to handle individual matters as they arise. It contacts government agencies and foreign governments in the District of Columbia and elsewhere with respect to goods to be delivered abroad. All contracts and such matters are negotiated in New York, where all orders are received, the participation of the Washington office being confined to expediting activities. Information is supplied to and derived from government agencies in the District of Columbia and elsewhere,

such as the International Co-operation Administration, the Bureau of Foreign Commerce, the Bureau of Public Roads, and the General Services Administration, all in connection with the regulatory activities of those agencies as they affect sales of and services for equipment shipped abroad, particularly in connection with the agencies' function of procuring on behalf of foreign recipients of international aid. The office is available as the contact through which such agencies expedite their orders. There is some contact with the Export-Import Bank, the World Bank, and the Development Loan Fund with respect to financing of foreign business. Passports and visas are obtained for General Motors personnel traveling abroad, and some work [fol. 459] is done with the Department of Justice on immigration problems of General Motors foreign personnel entering this country. Foreign government purchasing missions and foreign embassies who make inquiries at the office are referred to the headquarters in New York. Foreign embassies occasionally buy automobiles from Foreign Distributors Division in New York, who make the deliveries at the normal export shipping point in New Jersey. Similar arrangements are made for some United States Government personnel going abroad. The office has a public relations function of distributing press releases and gathering information which it returns to the New York headquarters. It exchanges information with trade association offices in the District.

20. *Motors Holding Division*

(A) The Motors Holding Division is headquartered in Detroit and has a branch office in Silver Spring, Maryland. From January 1, 1957 through May, 1959, the office was located in the District of Columbia. The branch territory covers the same ground as the local zone offices of the car manufacturing divisions, and thus includes the District of Columbia, most of Virginia and Maryland, and parts of Pennsylvania and West Virginia. The branch office personnel consist of the manager, his secretary, and an accounting supervisor who resides in Baltimore.

[fol. 460] (B) The function of Motors Holding Division is providing temporary capital financing for dealerships which are establishing, reorganizing or expanding. This is described in a booklet hereto attached as Exhibit 8-H. After a prospective new dealer has been selected by the car division, he submits to that division his request for capital assistance and is referred by the car division's zone manager to the Motors Holding branch manager. This is sometimes done in the zone manager's office; very rarely in the Motors Holding office. The Motors Holding branch manager then takes a statement from the applicant and makes an investment survey which includes the value of any assets proposed to be purchased from the outgoing dealer, if any, an analysis of the market independent of the zone's analysis, a physical inspection of facilities and inventories, and with the applicant negotiates an option to purchase any assets to be acquired and an option to lease the selected premises.

(C) After the negotiations are completed and the transaction has been reviewed and approved by Motors Holding Division's investment committee in Detroit, the applicant, now called the "operator," provides at least 25% of the total required capital, receiving therefor non-voting stock in a corporation organized for the purpose, and Motors Holding provides the balance, half for voting stock and half for interest-bearing notes. Thus, during the period of Motors Holding's investment, Motors Holding has all the voting stock and nominates a majority of the directors. [fol. 461] The dealer, however, operates the business, subject only to such control as Motors Holding deems necessary to provide security for its investment. Under the plan the operator is required to buy out Motors Holding's interest pursuant to a planned formula geared to operating results. A copy of the standard form of contract (which may occasionally be modified to meet special circumstances) is attached as Exhibit 9-I.

(D) After the investment has been made, the Motors Holding branch watches the dealership for sound operations and it obtains 10-day financial reports and reviews them for deficiencies. The accounting supervisor checks the

accounting records to assure the validity of such statements approximately every three or four months. The branch manager, who is a director, attends directors' meetings and stockholders' meetings. The accounting supervisor spends up to three days in a dealer's place of business on each visit. The branch manager may visit each dealership once a month or so, briefly or sometimes for several hours.

(E) During 1957 and 1958 there were four dealers in the District of Columbia who were being financed under the Motors Holding plan: Eaton Chevrolet, Inc., beginning October 29, 1957; General Truck Sales, Inc., beginning June 2, 1952; Hicks Chevrolet, Inc., beginning August 6, 1954 through November 30, 1958; and Peake Buick, Inc., beginning November 8, 1955 through August 15, 1957 (date [fol. 462] board of directors passed a resolution to liquidate the corporation).

21. *Patent Section*

The Patent Section has its headquarters in Detroit and maintains a branch office at 711-14 Street, Northwest (Sheraton Building) in Washington. Approximately 15 men are assigned to that office, most of them graduate engineers studying law at night. In addition, there are approximately five stenographer-typists, two of whom also do some work in making title searches in connection with patents. The primary function of the office is conducting patent and trade-mark investigations for infringement, validity, novelty, etc. at the United States Patent Office in the District. It also files patent, trade-mark and copyright applications. It does some detail work in connection with cases pending before the Court of Customs and Patent Appeals, before the Court of Claims, and before the Patent Office. It keeps in touch with the Patent Office to keep informed about changes in regulations, etc., and interviews examiners in connection with allowance of claims. It may also occasionally run errands to obtain information desired by the Patent Section from other government bureaus. It handles no licensing or other business matters related to patents, etc., all of which is done in Detroit (or sometimes Dayton or Bristol).

22. *Public Relations Staff*

(A) General Motors Public Relations Staff, headquar-
[fol. 463] tered in Detroit, maintains an office in the District of Columbia primarily as a listening post and for rendering services to visiting General Motors executives. The office consists of a manager, two staff assistants, an office manager, a man in charge of arranging hotel and transportation reservations, and eight clerks, telephone operators, chauffeur, mail clerk, etc.

(B) The manager has the function of supervising the office, so that the nature of his activities appears from the descriptions of his assistants. He is a registered lobbyist, although he has little, if any, occasion to do any lobbying. He keeps in touch with representatives of certain trade associations engaged in legislative activities, and assists as required in the preparation of statements of General Motors executives requested by Congressional committees. In particular, he sees to it that rules are followed with respect to the filing of copies of statements, etc., and consults with Committee staff members and Petitioner's executives in arranging hearing dates.

(C) One staff assistant is concerned primarily with the Washington press and magazine corps, plus other communications media, such as radio and television. This activity is at a much higher level of volume in Washington than in other cities because of the presence of news services and press representatives in the nation's capital. The function is to maintain contacts, answer questions, distribute re-
[fol. 464] leases, etc. The second staff assistant is concerned with obtaining information of the activities of government agencies which may be of interest to the Petitioner in matters other than procurement. He obtains copies of bills introduced into Congress, transcripts of some Congressional hearings, and other informational documents which in his judgment are of interest or which he is requested to obtain, and forwards them to the interested person in General Motors. He assists visiting General Motors executives in finding the right government personnel with whom to discuss problems and making appointments with them.

(D) The office provides miscellaneous services for visiting General Motors personnel, such as arranging hotel accommodations and transportation. It is also the initial contact point for visits by government personnel, school personnel, communications industry personnel, etc., to General Motors plants. Contact is maintained with trade associations having headquarters in Washington, such as the United States Chamber of Commerce.

Dated April 10, 1961.

[fol. 465]

PETITIONER'S EXHIBIT No. 4-b

GENERAL MOTORS CORPORATION

CHEVROLET MOTOR DIVISION

DEALER SELLING AGREEMENT

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[fol. 467]

Form No. GSD-T201-A-Chevrolet-56
U.S.A. Rev. 7-59

CHEVROLET MOTOR DIVISION

GENERAL MOTORS CORPORATION

Dealer Selling Agreement

THIS AGREEMENT, effective this_____ day of_____, A. D. 19____, by and between Chevrolet Motor Division—General Motors Corporation, hereinafter called Chevrolet, and

_____

an { individual
or { co-partnership of_____
a { corporation City County State

hereinafter called Dealer,

GENERAL PURPOSE OF THIS AGREEMENT

The purpose of this Selling Agreement is to set forth the functions and responsibilities of the parties in the sale by Chevrolet to Dealer of the motor vehicles, chassis, parts and accessories covered by this Agreement and the resale of those products by Dealer to its customers.

Both Chevrolet and Dealer recognize that in the manufacture, sale and service of motor vehicles the public is provided with a highly mechanized product of substantial value, the purchase of which is of major economic significance, and the usage of which has become to many a virtual necessity; and that the efficient and safe operation of motor vehicles is dependent upon the maintenance of the highest standards of production by the manufacturer and the highest standards of sales and service performance by the Dealer.

Chevrolet recognizes, therefore, that a sound dealer organization is essential to the public interest as well as to its own success, and desires a stable and prosperous dealer organization.

Chevrolet has elected to enter into this Selling Agreement with Dealer because of its confidence in Dealer's integrity and business ability. It expects of Dealer, and Dealer acknowledges, that Dealer will actively, aggressively and honestly promote the sale of the motor vehicles, chassis, parts and accessories covered by this Agreement to customers in its trade territory and give to the public prompt, efficient and courteous service; and that Dealer will conduct its business in a manner that will reflect favorably upon the Dealer and its operations, Chevrolet and Chevrolet products and will preserve the good will of the Dealer and its operations and the manufacturer, as well as the product good will that has been created by the production of motor vehicles, parts and accessories of the highest quality and design.

[fol. 468]

Dealer has elected to enter into this Selling Agreement with Chevrolet because of its knowledge of the Chevrolet reputation for integrity and fair business practices and of the customer acceptance for Chevrolet products. Dealer expects of Chevrolet, and Chevrolet acknowledges, that Chevrolet will produce and provide, at fair and competitive prices, motor vehicles, parts and accessories that are saleable in Dealer's territory and of a quality and design that under normal conditions and when properly adjusted and maintained, will give good performance for their owners; that, insofar as possible, Chevrolet will make such products available in quantities to meet Dealer's reasonable requirements in Dealer's trade area; that Chevrolet will assist in creating a demand for such products by advertising in various advertising media; and that Chevrolet will assist Dealer in the sale of such products by making available to Dealer, sales assistance and advice, advertising materials and campaigns, and instructions in sales and business methods.

IN CONSIDERATION of the foregoing and of the promises hereinafter made by the parties to each other, it is agreed as follows:

FIRST: Subject to the terms and conditions hereof, Chevrolet will sell and Dealer will buy Chevrolet motor vehicles and chassis with Dealer having the obligation to develop properly the sale thereof at retail particularly in the following area:

SECOND: The terms and conditions set forth in the attached "Terms and Conditions—Dealer", bearing Form No. GSD-T-202-Chevrolet-56 are hereby made a part of this Agreement with the same force and effect as if set forth at length herein.

THIRD: This is a personal contract, being enteted into in reliance upon and in consideration of the personal qualifications of and representations with respect thereto of the following named persons, who actively and substantially participate in the ownership or in the operations, or both in the ownership and in the operations of the Dealer:

[fol. 469]

PARTICIPATION IN DEALERSHIP

Name	Ownership	Operation
_____	☐	☐
_____	☐	☐
_____	☐	☐

The individual or individuals designated shall be responsible for any act or omission of any of Dealer's agents or employees which may be contrary to the purposes and objectives of this Agreement or the obligations of Dealer hereunder. Dealer shall not transfer or assign nor attempt to transfer this Agreement or any right or obligation hereunder. Dealer shall not make nor suffer to be made any change in the ownership, financial interests or active management of Dealer without the prior written approval of Chevrolet.

FOURTH: This Agreement shall continue in force and govern all relations and transactions between the parties for a term commencing on the stated date of execution hereof and expiring _____. At the end of the stipulated term, this Agreement shall automatically terminate without notice or action on the part of either party unless sooner terminated as hereinafter provided in Section 23.

FIFTH: This Agreement is not valid until and unless it bears the facsimile signature of the General Sales Manager and is countersigned by an Assistant General Sales Manager, a Regional Manager, an Assistant Regional Manager or Zone Manager of the Chevrolet Motor Division—General Motors Corporation.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement in duplicate as of the day and year first above written.

CHEVROLET MOTOR DIVISION
General Motors Corporation

Dealer_____
Firm Name

By_____
Officer of Firm and Title

By_____
Officer of Firm and Title

Town and State_____

Witness:_____

K. E. Sales
General Sales Manager

By_____
Zone Manager

(If executed by a representative of Dealer, title such as President, Partner, etc., must be indicated.)

If Dealer is a corporation, show State in which incorporated:_____

Form No. GSD-T202-Chevrolet-56
U.S.A.—3-56

CHEVROLET MOTOR DIVISION
GENERAL MOTORS CORPORATION

Terms and Conditions

Dealer

The following Terms and Conditions have by reference been incorporated in and made a part of the Selling Agreement which shall apply to and govern all transactions, dealings and relations between the parties:

SELLING RIGHTS, TERMS AND CONDITIONS OF SALE

1. Dealer's Selling Privilege

Dealer is granted the non-exclusive privilege of selling new Chevrolet motor vehicles and chassis and the non-exclusive privilege of using the word "Chevrolet" and the Chevrolet trade-mark or trade-marks, including the distinctive outline or form thereof, as applied to Chevrolet motor vehicles and chassis, parts and accessories.

2. Handling of Dealer's Orders

A. Three Months' Estimate of Requirements

To enable Chevrolet to establish production schedules, and to place orders with its suppliers on the basis of the lead time normally required in the automobile mass production industry, and to have such schedules reflect the best combined estimate of Chevrolet and its dealers of Chevrolet motor vehicle and chassis requirements for future retail deliveries, Dealer will, unless otherwise advised by Chevrolet, furnish Chevrolet every month, on forms provided by Chevrolet, an estimate of Dealer's requirements of new Chevrolet motor vehicles and chassis for the next three (3) calendar months, each month's estimate to be shown separately.

B. Ten-Day Report

To assist Chevrolet in the evaluation of current market trends and in the adjustment of established future production schedules, as well as current production schedules to the extent possible, Dealer will furnish Chevrolet, every ten (10) days, with a report known as the "Ten-Day Report" on forms supplied by Chevrolet. Such report shall show retail sales of both new and used cars made during said period, new and used car stocks, and unfilled orders on hand at the end of said period.

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C. *Orders*

Dealer shall submit orders for Chevrolet motor vehicles and chassis to Chevrolet for acceptance at mutually satisfactory periods. Such orders shall be submitted upon order forms supplied by Chevrolet. Accepted orders for any standard products not shipped during the month for which delivery was scheduled will remain in effect unless cancelled in whole or in part by either party upon written notice to the other. However, orders for "special" motor vehicles and chassis, accepted by Chevrolet for the convenience of Dealer, may be cancelled only by Chevrolet.

Any motor vehicle or chassis which differs from Chevrolet's standard specifications and/or incorporates special equipment, and which because of such difference in specifications or increase in price has only a limited use or marketability, shall be considered "special".

D. Failure to Fill Orders

Chevrolet shall not be liable for failure or delay in filling orders of Dealer, which have been accepted by Chevrolet, where such failure or delay is due, in whole or in part, to any labor, material, transportation, or utility shortage or curtailment, or to any labor trouble in the plants of Chevrolet or its suppliers, or to any cause beyond the control or without the fault or negligence of Chevrolet. Dealer shall not be liable for any failure to accept shipments of products ordered from Chevrolet, where such failure is due to any labor trouble in Dealer's establishment or any cause beyond the control or without the fault or negligence of Dealer.

3. Payment by Dealer

Dealer shall pay Chevrolet for each shipment of new Chevrolet motor vehicles and chassis, Dealer's price established by Chevrolet and in effect at the time of such shipment, together with a factory handling charge determined by Chevrolet, which shall include reimbursement to Chevrolet for any tax which it has paid, incurred or agreed to pay on any such motor vehicles or chassis, on the following terms: Cash, sight draft, or sight draft with bill of lading attached payable with collection charges. Dealer shall pay interest on all drafts in the amounts and from the dates specified therein.

4. Car Shipments

A. Mode of Shipment

To integrate the shipment of assembled vehicles from plant sites with continuing plant production, to minimize required shipping facilities and areas, and to facilitate and expedite loading and transportation of vehicles by carriers, Chevrolet will select the distribution point and the mode of transportation, but Chevrolet will endeavor, whenever practicable, to follow Dealer's requests with respect to routing and mode of transportation. Chevrolet will prepay all charges, including transportation charges, for the delivery of motor vehicles and chassis made to Dealer hereunder.

B. Delivery Charges

In addition to the prices and charges otherwise provided for herein, Dealer will pay Chevrolet the destination charges established by Chevrolet and in effect at the time of shipment for motor vehicles and chassis delivered to Dealer hereunder. Chevrolet has the right at any time to change destination charges, to issue new applicable bulletins, and, if necessary, new applicable Price Lists.

C. Liability for Demurrage

Dealer shall be responsible for and shall pay any and all charges for demurrage, storage, or other charges accruing after arrival of such shipment at destination.

D. Diversion

If diversions are made upon Dealer's request or as a result of Dealer's failure or refusal to accept motor vehicles or chassis that may be shipped Dealer on Dealer's orders, unless such failure or refusal is excusable under the provisions of Section 2D hereof, Dealer will assume responsibility for and pay the additional charges and expenses incident to such diversion.

E. Claims

All claims for loss of or damage to shipments of motor vehicles and chassis shipped hereunder while in the possession of the transportation agency shall be submitted to Chevrolet by Dealer within twenty (20) days after date of delivery of shipment to Dealer.

5. Change in Pricing

A. Right to Change Prices

Chevrolet has the right at any time to change prices, discounts, terms and provisions affecting any current models or body types of motor vehicles or chassis, and to issue new applicable Price Lists or bulletins.

If Chevrolet changes prices, discounts, terms and provisions, such changed prices, discounts, terms and provisions shall apply to all motor vehicles and chassis ordered by Dealer and unshipped by Chevrolet at the time that the same are made effective by Chevrolet.

B. Price Increases

Except with respect to the pricing of new yearly models or body types at the introduction thereof, Chevrolet shall give written notice to Dealer of any change increasing the price to be paid by Dealer before shipping any current motor vehicles or chassis to which such change is applicable. Upon receipt of such notice, Dealer may cancel or modify orders for motor vehicles or chassis to which any such change applies, provided written notice of cancellation is delivered to Chevrolet within ten (10) days after receipt by Dealer of Chevrolet's notice. All unshipped orders not cancelled as provided herein shall remain in effect for delivery in accordance with said change.

C. Price Reductions

If Chevrolet reduces the list price on any of its current models or body types of motor vehicles or chassis, Chevrolet will refund or credit as an allowance to Dealer on all new and unused motor vehicles and chassis of current model and body type, purchased from Chevrolet or purchased from another authorized Chevrolet dealer during the twelve (12) months immediately preceding the date of such reduction and carried in Dealer's stock as new and unsold at the time such reduction is made, an amount equal to the difference between the price Dealer shall have paid Chevrolet, or would have paid Chevrolet if such units had been purchased from Chevrolet, for any such motor vehicles or chassis and the reduced amount then payable for the same; provided, however, that no refund will be made upon any motor vehicle or chassis used by Dealer for demonstration purposes, nor will any such refund be granted unless written claim therefor, properly documented with supporting data, be made by Dealer in writing within thirty

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(30) days from the date that such reduction becomes effective. In the case of motor vehicles or chassis purchased by Dealer under a title retaining instrument Chevrolet reserves the right to pay such difference in price to the holder of the instrument for accour.. of Dealer.

6. Model Change

In the event that Chevrolet shall, at any time, discontinue current models and body types of Chevrolet motor vehicles or chassis, and substitute in place thereof new models and body types, Chevrolet will make an allowance to Dealer on the total number of new unused motor vehicles and chassis of such discontinued models or body types purchased from Chevrolet, or from another authorized Chevrolet dealer, prior to such model change and still in Dealer's stock unsold on the date hereinafter specified.

The amount of such allowance and the time of payment shall be determined by Chevrolet. Such allowance, however, shall in no case be less than five per cent (5%) of the list price of Chevrolet motor vehicles and chassis of such models and body types about to be discontinued.

The allowance will not be made on any motor vehicles or chassis used by Dealer for demonstration purposes.

The date on which Dealer's stock of discontinued models shall be determined shall be either the Announcement Day designated by Chevrolet on which the new models and body types are officially announced to the general public (local preview announcements excepted), or a date prior thereto designated by Chevrolet.

All claims for the allowance must be made in writing within thirty (30) days from the Announcement Day or the prior date designated by Chevrolet, as the case may be, and must be properly documented with supporting data. If Chevrolet elects to designate a date prior to Announcement Day, Chevrolet will make the same allowance with respect to purchases by Dealer from Chevrolet of corresponding Chevrolet motor vehicles and chassis of those models and body types about to be discontinued made between said designated date and Announcement Day.

7. Model Change at Reduced List Price

If, at the time new models or body types are announced, the list prices of such new models or body types are reduced from the list prices of the same model or body type of the discontinued series, Chevrolet will refund or credit to Dealer a proportionate amount on the price paid to Chevrolet by Dealer, or the price Dealer would have paid to Chevrolet if such units had been purchased from Chevrolet, for those new unused motor vehicles and chassis of the discontinued series purchased from Chevrolet or purchased from another authorized Chevrolet dealer which are in Dealer's stock unsold at the time such new models and body types are announced, provided, however, that such refund will not be paid in the case of such radical changes in size, design and price as to make such new models and body types, for all practical purposes, a new and different series or line of motor vehicles. In the latter event Chevrolet will make such refund or allowance as shall, in its opinion, seem equitable under the circumstances.

Dealer will be entitled to receive the refund allowable under this Section in addition to such allowance as Dealer may be entitled to under Section 6.

8. Change of Design

Chevrolet may change the design of any new Chevrolet motor vehicle, chassis, accessories or parts thereof at any time without notice and without obligation to make the same or any similar change upon any Chevrolet motor vehicle, chassis, accessories or parts thereof, previously purchased by or shipped to Dealer or being manufactured or sold in accordance with Dealer's orders. Such changes shall not be considered Model Changes as contemplated by Section 6 hereof.

9. Warranty

There are no warranties, expressed or implied, made by Chevrolet to Dealer on the Chevrolet motor vehicles, chassis or parts furnished hereunder except to the extent comprehended in the following:

"The Manufacturer warrants each new motor vehicle, including all equipment or accessories (except tires) supplied by the Manufacturer, chassis or part manufactured by it to be free from defects in material and workmanship under normal use and service, its obligation under this warranty being limited to making good at its factory any part or parts thereof which shall, within ninety (90) days after delivery of such vehicle to the original purchaser or before such vehicle has been driven 4,000 miles, whichever event shall first occur, be returned to it with transportation charges prepaid and which its examination shall disclose to its satisfaction to have been thus defective; this warranty being expressly in lieu of all other warranties, expressed or implied, and all other obligations or liabilities on its part, and it neither assumes nor authorizes any other person to assume for it any other liability in connection with the sale of its vehicles.

"This warranty shall not apply to any vehicle which shall have been repaired or altered outside of an authorized Chevrolet Service Station in any way so as in the judgment of the Manufacturer to affect its stability and reliability, nor which has been subject to misuse, negligence or accident."

10. Parts and Accessories

A. Selling Rights

Chevrolet hereby grants to Dealer the non-exclusive right to sell new Chevrolet parts and accessories and Chevrolet will sell Dealer direct or through a designated parts warehouse, such new Chevrolet repair parts and accessories.

"Chevrolet parts and accessories" as used in this Agreement are defined as being parts and accessories manufactured by or for Chevrolet, designed for use on Chevrolet motor vehicles or chassis, and distributed by Chevrolet or any division or subsidiary of General Motors Corporation.

B. Prices

Sale of parts and accessories to Dealer will be made according to the prices, terms and provisions established by Chevrolet and in effect at the time of shipment.

C. Billing and Payment

The parts and accessories account of Dealer is due and payable, as per statement rendered, on or before the date specified by Chevrolet. If Chevrolet for reasons of credit deems it necessary to place shipments on a C.O.D. basis, collection charges, if any, are to be paid by Dealer.

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D. Return of Defective Parts and Accessories

After notifying Chevrolet and receiving specific shipping instructions therefor from Chevrolet, Dealer may return for credit defective Chevrolet parts and accessories purchased direct from Chevrolet or acquired as the result of performing warranty adjustments in accordance with the provisions of subsection 19F hereof, at the then current dealer net price of such parts or accessories plus ten per cent (10%); such parts and accessories to be packaged or crated and shipped, transportation charges prepaid. Dealer will be reimbursed for transportation charges prepaid by Dealer on authorized shipments of defective parts and accessories.

E. Return of Inactive Parts

In the event Dealer develops an inactive stock of Chevrolet parts, or for any other reason desires to liquidate a portion of its parts stock, Dealer may submit to Chevrolet a list of those parts purchased direct from Chevrolet, in good condition and unused, which Dealer desires to return for credit. Chevrolet shall promptly review said list and notify Dealer as to which parts will be accepted, the prices therefor and the proper shipping instructions. Thereupon Dealer may package or crate and ship such parts, transportation charges prepaid, in accordance with Chevrolet's instructions.

F. Right to Return Parts Within Ninety Days —Accessories Within Thirty Days

Dealer may return any new Chevrolet parts purchased direct from Chevrolet, which are in good condition and unused, for credit within ninety (90) days after receipt thereof by Dealer. Dealer may also return any new Chevrolet accessories, anti-freeze and other service supplies purchased direct from Chevrolet, which are in good condition and unused, for credit within thirty (30) days after receipt thereof by Dealer; provided further, however, that if Dealer shall have purchased accessories direct from Chevrolet for use in connection with specific motor vehicles for which orders have been placed with and accepted by Chevrolet and such motor vehicles are not shipped to Dealer prior to the introduction of new motor vehicle models, thereby cancelling such orders, then to the extent such accessories are not useable on the new models and are in excess of Dealer's requirements they may also be returned to Chevrolet for credit. Such parts, accessories and service supplies shall be packaged or crated and shipped to the destination specified by Chevrolet, transportation charges prepaid. Credit on new Chevrolet parts and accessories will be at Dealer's net cost. Dealer shall be entitled to return accessories whether same were purchased separately or shipped on or with a new Chevrolet motor vehicle.

Dealer, however, will not be entitled to return materials which are acquired or fabricated specially by Chevrolet upon Dealer's order for a particular service order or car, including unlisted parts or assemblies and any cut or fabricated upholstery or trim items.

OPERATING REQUIREMENTS

11. Dealer's Place of Business

In order to provide product representation commensurate with the good will attached to the name "Chevrolet" and to facilitate the proper sale and servicing of Chevrolet motor vehicles, chassis, parts and accessories, Dealer will main-

tain a place of business satisfactory as to appearance and location, and adequate in size and layout for new car sales operations, service operations, parts and accessories sales and used car sales, and will maintain the business hours customary in the trade.

Once Dealer is established in facilities and at a location mutually satisfactory to Dealer and Chevrolet, Dealer will not move to or establish a new or different location, branch sales office, branch service station, or place of business including any used car lot or location without the prior written approval of Chevrolet.

12. Capital Requirements

Since the amount and structure of working capital and net worth required to handle properly the business to be conducted by Dealer hereunder depends upon many factors, including size of market, sales and service facilities required, anticipated volume and others, and since Chevrolet has set standards for the capital and net worth of all its dealers based on Chevrolet's past experience, Dealer, at the time of execution of this Agreement, shall establish its owned net working capital and net worth in the respective amount and form specified by Chevrolet. If, subsequently due to changed conditions, the amount of owned net working capital or net worth should be materially increased or decreased, or if the way in which either is set up should be changed in any respect for the proper handling of Dealer's business, Dealer and Chevrolet will negotiate to establish a revised amount and structure of working capital or net worth to meet such changed conditions, and Dealer will meet such revised capital requirements within the time agreed upon.

13. Accounts and Records

A. Uniform Accounting System

It is to the mutual interests of Chevrolet and Dealer that uniform accounting systems and practices be maintained by dealers in order that Chevrolet may develop standards of operating performance which will enable dealers to obtain the most satisfactory results from the sales potentials assigned to them, and which will enable Chevrolet to prepare composite dealer profit statements periodically to guide Chevrolet in formulating policies beneficial to the dealers' interests.

Accordingly, Dealer will use and keep up to date a satisfactory uniform accounting system of a type designated by Chevrolet and will furnish to Chevrolet by the tenth of each month a complete and accurate financial and operating statement with supporting data covering the preceding month's operations, showing the true and actual condition of Dealer's business. Dealer will maintain said system in accordance with the Accounting Manual prescribed by Chevrolet.

B. Examination of Accounts and Records

In order to assure the maintenance of an accounting system of a type designated by Chevrolet, Dealer will permit an examination of its accounts and records to be made by a person or persons, either in the employ of Chevrolet or acceptable to Chevrolet. A copy of the report of such examination will be furnished to both Chevrolet and Dealer.

14. Sale of Motor Vehicles

Dealer shall provide satisfactory sales performance and render satisfactory service to owners in the area described in Paragraph First. Evaluation of Dealer's sales performance shall be based on

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the relationship of Dealer's sales of new Chevrolet passenger cars and trucks in such area, to the sales of other makes of passenger cars and trucks directly competitive therewith both in price and in product in such area, as compared to a similar relationship of the sales of new Chevrolet passenger cars and trucks to other makes of passenger cars and trucks directly competitive therewith specifically in the Chevrolet Zone area wherein Dealer is located, but not necessarily to the exclusion of the Chevrolet Regional area or the National area. Such evaluation shall be based on records generally accepted for such purposes by the automobile industry and shall also take into account other pertinent factors, such as the trend of Dealer's sales performance over a reasonable period of time, the availability and the delivery of Chevrolet passenger cars and trucks to Dealer, and local conditions directly affecting such sales performance.

Where one or more other Chevrolet dealers are located within the area described in Paragraph First, the evaluation of the combined sales performance of all Chevrolet dealers in such area shall be made as provided above, and Dealer shall contribute its fair share to the sales performance rating for the area. In evaluating Dealer's contribution to the sales performance rating for such area consideration shall be given to such factors as Dealer's sales performance over a reasonable period of time, the availability and delivery of Chevrolet passenger cars and trucks to Dealer, the geographic location of Dealer's place of business and the general shopping habits of the buying public within such area, Dealer's sales participation experience within such area, and Dealer's standard of sales participation within such area (if any) previously determined and accepted by Dealer and Chevrolet.

15. Sales Staff

Dealer shall maintain a staff of salesmen and a selling and customer relations organization adequate to take care of the sales potential of the area described in Paragraph First.

16. Sales and Service Records

In furtherance of the purposes, objectives, and obligations provided for in this Agreement, Dealer will keep complete and up-to-date records regarding the sale and servicing of new Chevrolet motor vehicles and chassis and will permit Chevrolet at all reasonable times in business hours to inspect such records.

17. Customer Complaints

Dealer will receive, investigate and handle all complaints received from customers or prospective customers with a view to securing and maintaining the good will of the public toward Dealer, Chevrolet and Chevrolet products.

18. Treatment of Purchasers

A. Informing Purchasers as to Details of Their Purchases

Dealer will inform retail purchasers of Dealer's delivered prices and will give them itemized invoices covering the details of their purchases.

B. Representations as to Contents of Charges

Dealer will not make any misleading statements or misrepresentations as to the items making up its total selling price, or as to the prices related to such items, nor make any statements intended to lead any purchaser to believe that a greater

portion of the selling price of a new Chevrolet motor vehicle or chassis represents destination charges and factory handling charges than the amounts of such items actually charged to and paid for by Dealer.

C. Right of Retail Purchaser to Buy a New Car Without Purchasing Optional Equipment or Accessories

Dealer recognizes that a retail customer has the right to purchase new Chevrolet motor vehicles without being required to purchase any optional equipment or accessories and Dealer, therefore, will either remove any optional equipment or accessories which the purchaser does not want, or will immediately order a new Chevrolet motor vehicle without such optional equipment or accessories.

D. Advertising

Both Chevrolet and Dealer recognize the need of maintaining the highest standards of ethical advertising at all times in order to secure and maintain public confidence in Dealer, Chevrolet and Chevrolet products.

Accordingly, Chevrolet will not publish, cause to be published, encourage or approve any advertising relating to Chevrolet products which is likely to mislead or deceive the public, and Dealer will not publish, cause to be published or approve any advertising relating to Dealer's sale of Chevrolet products which is likely to mislead or deceive the public.

19. Care of Owner

A. Conditioning of New Motor Vehicles

Dealer will condition each new motor vehicle and chassis before delivery, in accordance with Chevrolet's pre-delivery inspection schedule.

B. Owner's Service Policy

Dealer will execute and deliver to each person who purchases a new Chevrolet motor vehicle or chassis from Dealer, an "Owner's Service Policy", on forms furnished by Chevrolet. Dealer will promptly perform and fulfill all the terms and conditions of said Policy and authorizes Chevrolet to charge its account at the uniform rate established by Chevrolet for coupons covering inspections on new Chevrolet motor vehicles sold by Dealer and performed by other Chevrolet dealers under such "Owner's Service Policy".

C. Stock of Parts

Dealer will carry in stock at all times during the life of this Agreement an adequate number and assortment of parts and accessories to render proper service to owners of Chevrolet motor vehicles and chassis.

D. Representations as to Parts

Dealer will not sell, offer for sale, or use in the repair of Chevrolet motor vehicles and chassis as new Chevrolet repair parts, any part or parts which are not in fact new Chevrolet repair parts as defined in subsection A of Section 10 of this Agreement.

E. Mechanical Staff

Dealer will employ a sufficient number of competent mechanics to meet adequately the service requirements of the Chevrolet owners.

F. Warranty Adjustment

Dealer will replace any defective part or parts in fulfillment of the warranty set forth in Section 9 hereof without expense to the owners of such vehicles. For such warranty work and for other policy and warranty work performed by Dealer

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for Chevrolet's account Chevrolet will reimburse Dealer therefor as follows:

Parts: If the replaced part or parts are returned to and found by Chevrolet to be defective, Chevrolet will pay or credit to Dealer an amount equal to the then current Dealer net price of such part or parts plus ten per cent (10%). The return of such parts to Chevrolet shall be made in accordance with the provisions of subsection 10D hereof.

Labor: Chevrolet will pay or credit Dealer on the basis of the Chevrolet Flat Rate System of time allotments as recommended and furnished by Chevrolet at one hundred per cent (100%) of the labor rates related thereto as agreed upon with Chevrolet.

G. Customer Relationship

Dealer will make every reasonable effort to satisfy owners of Chevrolet motor vehicles and chassis and all persons purchasing Chevrolet motor vehicles and chassis from Dealer, and will establish regular contact either by correspondence or personal interview, with such owners or purchasers. All complaints received by Dealer, which cannot be readily remedied, shall be promptly reported in detail to Chevrolet.

20. Signs

Dealer will purchase, erect, and maintain at Dealer's expense the following signs:

A. Product Sign

A standard product electric sign in a conspicuous place outside Dealer's showrooms provided the erection thereof is not prohibited by municipal ordinance or statute.

B. Service Sign

A standard authorized service sign in a suitable location on the outside of Dealer's place of business.

C. Other Necessary Signs

Such other signs as are necessary to advertise Dealer's business properly on a basis mutually satisfactory to both Chevrolet and Dealer.

21. Chevrolet Name and Trade-Marks

A. Chevrolet's Exclusive Rights

Chevrolet is entitled to the use of the word "Chevrolet", and the Chevrolet trade-mark or trade-marks, including the distinctive outline or form thereof, as applied to motor vehicles and chassis, parts and accessories.

B. Discontinuance of Use Upon Termination

If the word "Chevrolet" is used in the name under which Dealer's business is conducted or the word "Chevrolet" or any Chevrolet trade-mark, including the distinctive outline or form thereof, is used in any sign or advertising displayed by Dealer, Dealer will, upon termination of this Agreement, or upon the request of Chevrolet, discontinue the use of the same. Thereafter Dealer will not use, either directly or indirectly, in connection with any motor vehicle business, any Chevrolet trade-mark, including the distinctive outline or form thereof, the word "Chevrolet" or any other name, title, expression or mark so nearly resembling the same as to be likely to lead to confusion or uncertainty, or to deceive the public. If Dealer is a corporation in whose corporate name the word "Chevrolet" is used, Dealer will promptly have the corporate name changed, eliminating said word "Chevrolet" therefrom.

C. Dealer's Liability for Failure to Discontinue Use

If Dealer, after termination of this Agreement, shall refuse or neglect to keep and perform the provisions of subsection B above, Dealer shall reimburse Chevrolet for all costs, attorneys' fees and other expenses incurred by Chevrolet in connection with legal action to require Dealer to comply therewith.

22. Advertising and Promotional Fund

In order to give Chevrolet dealers the advantage of a comprehensive and coordinated dealer advertising program, an Advertising and Promotional Fund, composed of a dealer portion and a factory portion, has been established and is administered by Chevrolet in accordance with the provisions set forth in the Chevrolet Dealer Price List.

A. Dealer Contributions

Chevrolet will collect the amount set forth in the Chevrolet Dealer Price List as the "Dealer Contribution" for each new Chevrolet motor vehicle and chassis purchased and paid for by Dealer, and such amount will be credited to the dealer portion of the Fund for the account of Dealer.

B. Factory Contributions

Chevrolet will pay into the Fund the amount set forth in the Chevrolet Dealer Price List as the "Factory Contribution" for each new Chevrolet motor vehicle and chassis purchased and paid for by Dealer, and such amount will be credited to the factory portion of the Fund.

C. Modification of Advertising Program

During the term of this Agreement the provisions of the aforesaid advertising program may be modified from time to time either to limit its application and coverage or to broaden its application and coverage to include such items as sales promotional activities. Likewise, the amount of the Dealer and Factory Contributions for each new Chevrolet motor vehicle and chassis purchased and paid for by Dealer may be increased or decreased from time to time with the announcement of new yearly model motor vehicles to compensate for increases or decreases in advertising and other costs; provided, however, that the amount of the Factory Contribution to the Fund for each new Chevrolet motor vehicle and chassis purchased and paid for by Dealer shall at no time be less than fifty per cent (50%) of the amount of the Dealer Contribution for each such motor vehicle and chassis.

TERMINATION OF AGREEMENT

23. Termination

A. Termination by Dealer

Dealer may terminate this Agreement by written notice of termination delivered to Chevrolet, such termination to be effective one (1) month after receipt by Chevrolet of such notice.

B. Termination for Cause

(1) If Chevrolet or Dealer requires a license for the performance of any obligation under or in connection with this Agreement in any state or jurisdiction where this Agreement is to be performed, then, and in such event if either of the parties shall fail to secure or

maintain a license or renewal thereof or if such license shall be suspended or revoked, irrespective of the cause or reason therefor, either party may immediately terminate this Agreement by giving to the other party written notice of such termination.

(2) If Dealer does not conduct its business in accordance with any requirement set forth in Sections 11 through 17, inclusive, or Section 19 of this Agreement, Chevrolet may terminate this Agreement by giving to Dealer written notice of termination to be effective three (3) months after receipt of such notice.

(3) In the event of the death or incapacity of Dealer or any person named in Paragraph Third hereof Chevrolet may terminate this Agreement. However, to facilitate an orderly termination of the business relationships between Chevrolet and Dealer and any contemplated liquidation of the business of the dealership, Chevrolet will, upon receipt of written request therefor made by the executor(s), administrator(s) or representative(s) of the deceased or incapacitated person within thirty (30) days from the date of such death or incapacity, defer the exercise of such right to terminate and will continue to operate with Dealer under the terms of this Agreement for a period, to be determined by Chevrolet, of not less than ninety (90) days and not more than one (1) year from the date of such death or incapacity and this Agreement will terminate at the expiration of such period. If such written request is not received by Chevrolet within such thirty (30) day period, Chevrolet may then terminate this Agreement.

(4) Chevrolet may terminate this Agreement immediately by delivering to Dealer or its representative written notice of such termination in the event of the happening of any of the following:

a. Removal, resignation, withdrawal or elimination from Dealer or dealership for any reason of any person named in Paragraph Third of this Agreement.

b. Any attempted transfer or assignment of this Agreement or any right or obligation hereunder.

c. Any misrepresentation to Chevrolet as to the direct and/or indirect ownership of Dealer, or any sale, transfer, relinquishment, voluntary or involuntary, by operation of law or otherwise, of any interest in the direct or indirect ownership or active management of Dealer without the prior written approval of Chevrolet.

d. Any dispute, disagreement, or controversy between or among principals, partners, managers, officers or stockholders of Dealer which may adversely affect the ownership, operation, management, business or interest of Dealer, dealership, or Chevrolet.

e. Insolvency of Dealer; filing of a voluntary petition in bankruptcy by Dealer; filing of a petition to have Dealer declared bankrupt, provided that it is not vacated within thirty (30) days from date of filing; appointment of a receiver or trustee for Dealer, provided such appointment is not vacated within thirty (30) days from the date of such appointment; execution by Dealer of an assignment for the benefit of creditors.

f. Conviction of Dealer or any principal

officer, principal stockholder or manager of Dealer or any partner in Dealer or dealership of any crime which, in the opinion of Chevrolet, may adversely affect the good will or interests of Dealer, dealership or Chevrolet.

g. Failure of Dealer to maintain dealership operation as a going business, open during customary business hours, for seven consecutive business days, provided such failure is not due to causes beyond Dealer's control and is without Dealer's fault or negligence.

24. Transactions After Termination

A. Effect of Termination on Orders

In the event that a new Selling Agreement is not entered into by the parties upon expiration of this Agreement or in the event that this Agreement is terminated in accordance with any provision of Section 23, all orders of Dealer for motor vehicles, chassis, parts and accessories then outstanding shall be automatically cancelled. Termination of this Agreement shall not release Dealer, however, from the obligation to pay any sum which may then be owing Chevrolet or from the obligation to pay for any motor vehicle, chassis, or equipment for same which i special, as defined in subsection C of Section 2 of this Agreement, and which may have been ordered by Dealer and not shipped prior to any termination of this Agreement.

B. Termination Deliveries

In the event of termination of this Agreement under the provisions of subsection A of Section 23, or subsection B(3) of Section 23 without any deferment of termination as provided for therein, but not otherwise, Chevrolet will use its best efforts to furnish Dealer with Chevrolet motor vehicles and chassis to fill Dealer's bona fide retail orders on hand on the date of termination not to exceed, however, the total number of motor vehicles and chassis delivered to Dealer by Chevrolet during the three (3) months immediately preceding the effective date of termination, subject, to the following conditions and limitations:

(1) Within ten (10) days following termination, Dealer shall deliver to Chevrolet a written schedule of Dealer's bona fide retail orders on hand on the dat of termination. Such schedule shall show the name and address of each retail customer and the details with respect to each motor vehicle ordered, including model, body type, color and accessories and shall specify each bona fide order against which Dealer desires Chevrolet to make delivery up to the total number of motor vehicles required to be delivered by Chevrolet as above described. Those orders for which delivery is thus specified by Dealer, when approved by Chevrolet, shall constitute Dealer's Schedule of Termination Deliveries. No changes or substitution may be made by Dealer in such Schedule of Termination Deliveries and Chevrolet will not be obligated to make deliveries of any motor vehicle to Dealer except as specified therein. In the event of Dealer's failure to deliver to Chevrolet the detailed Schedule above required, Dealer shall have no further rights.

(2) Dealer shall accept any motor vehicle required to be delivered by Chevrolet hereunder against Dealer's Schedule of Termination

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Deliveries immediately upon notification by Chevrolet of the availability to Dealer of such vehicle and in accordance with the terms and conditions of sale established by Chevrolet and in effect at the time of shipment. In the event of its failure to do so, Dealer shall have no further right to receive such vehicle or any other vehicle in lieu of it.

(3) Vehicles shall be delivered by Chevrolet hereunder in substantial accordance with the schedule and basis of delivery in effect with respect to other dealers in the same zone at the time of Dealer's termination.

(4) Dealer shall give Chevrolet notice immediately of cancellation for any reason of any retail order set forth in Dealer's Schedule of Termination Deliveries.

(5) In the event of the cancellation for any reason of any retail order set forth in Dealer's Schedule of Termination Deliveries before delivery by Chevrolet of a motor vehicle to apply against such order, Chevrolet shall be released from any obligation to make delivery of such vehicle.

(6) Dealer shall provide proper and adequate facilities in accordance with the terms and provisions of this Agreement to effect the delivery and handling of motor vehicles to be supplied upon termination under this subsection 24B.

C. *Effect of Transactions After Termination*

The acceptance of orders from Dealer or the continuance of sale of products to Dealer or any other act of Chevrolet after termination of this Agreement shall not be construed as a renewal of this Agreement for any further term nor as a waiver of the termination.

D. *Rights of Surviving Persons Named in Paragraph Third*

If this Agreement should be terminated by Chevrolet under the provisions of subsection 23 B(3) or 23 B(4)a and at the time of such termination another person is named in Paragraph Third on the basis of being qualified as an operator as distinguished from being qualified solely on the basis of a financial interest, and if such other person owns a financial interest of at least twenty-five per cent (25%) or acquires such an interest within a reasonable time (considering then existing circumstances) after the date of such termination, then, subject to the provisions of any Widow's Financial Participation Addendum and any Interim Agreement Addendum signed by all parties named in Paragraph Third of this Agreement, and unless the right to receive the offer hereinafter provided for has been waived in an Interim Agreement Addendum by the party otherwise entitled hereunder to receive such offer, Chevrolet shall offer such other person a new Selling Agreement for the unexpired balance of the term of the Selling Agreement being terminated. If more than one other person be named in Paragraph Third at the time of such termination who can qualify under the conditions set forth above for such a new Selling Agreement, such persons must agree in writing as to which one will be offered the new Selling Agreement. If such persons do not agree as to the successor dealer within a reasonable time, Chevrolet shall not be obligated to offer a new or substitute Selling Agreement to any of such persons.

25. Chevrolet's Right to Repurchase When Agreement is Terminated

In the event of termination of this Agreement; or in the event Chevrolet does not offer Dealer a new Selling Agreement upon the expiration of the term of this Agreement:

A. Chevrolet will purchase from Dealer and Dealer will sell to Chevrolet:

Cars

(1) All new and unused Chevrolet motor vehicles and chassis of the current model on hand in Dealer's place of business or in Dealer's possession at Dealer's net cost, including destination charges paid to Chevrolet thereon.

Parts

(2) All unused and undamaged Chevrolet repair parts listed in Chevrolet's current Dealer Parts and Accessories Price Schedule and purchased direct from Chevrolet, or purchased from an outgoing Chevrolet dealer as a part of Dealer's initial Chevrolet parts inventory, and on hand in Dealer's place of business or in Dealer's possession at the then current dealer net prices plus five per cent (5%) thereof for packing costs and plus reimbursement for transportation charges to destination specified by Chevrolet.

Accessories

(3) All unused and undamaged Chevrolet accessories and service supplies purchased direct from Chevrolet during the twelve (12) month period immediately preceding the effective date of such termination and on hand in Dealer's place of business or in Dealer's possession at the then current dealer net prices plus five per cent (5%) thereof for packing costs and plus reimbursement for transportation charges to destination specified by Chevrolet.

Comm. Bodies

(4) All new and unused commercial bodies and cabs of current models purchased direct from Chevrolet on hand in Dealer's place of business or in Dealer's possession at Dealer's net prices according to current Price Lists then in force plus transportation charges paid to Chevrolet thereon. In the event that any such commercial bodies or cabs have been mounted on chassis by Dealer, the price to be paid therefor shall be the net price to Dealer for the complete unit according to current list prices, even though Dealer purchased same separately at a higher price.

Signs

(5) Any signs belonging to Dealer of a type recommended in writing by Chevrolet and bearing the word "Chevrolet", at a price mutually agreed upon by Chevrolet and Dealer. If Chevrolet and Dealer cannot agree on a price, they shall select a third party who shall set the price.

B. If Dealer desires to sell the same, Chevrolet will purchase all the special tools of a type recommended by Chevrolet and designed specifically for service of Chevrolet motor vehicles which were purchased by Dealer during the three (3) year period immediately preceding termination, while Dealer has been

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operating under a Chevrolet Selling Agreement, at a price mutually agreed upon by Chevrolet and Dealer. If Chevrolet and Dealer cannot agree on a price, they shall select a third party who shall set the price.

C. Dealer shall, within thirty (30) days following the date of termination, furnish Chevrolet with a list of the motor vehicles, chassis, parts, accessories, signs and tools aforesaid.

D. Upon demand and tender by Chevrolet of the purchase price determined as aforesaid, Dealer will deliver such goods to Chevrolet forthwith in accordance with Chevrolet's instructions.

E. Dealer shall execute and deliver to Chevrolet any instruments necessary to convey title to the aforesaid property. If such property is subject to lien or charge of any kind Dealer will procure the discharge and satisfaction thereof prior to the repurchase of such property by Chevrolet.

26. Loss on Premises

A. *Premises Owned by Dealer*

1. Terminations to Which Applicable

In the event of termination of this Agreement by Chevrolet under the provisions of subsection B (2) of Section 23 hereof, or in the event Chevrolet terminates this Agreement because of Chevrolet's failure to secure or maintain any required license or renewal thereof as provided in subsection B (1) of Section 23 hereof, or in the event Chevrolet terminates this Agreement because of the incapacity, for reasons of health, of Dealer or any person named in Paragraph Third of the Agreement, or in the event Chevrolet does not offer Dealer a new Selling Agreement upon the expiration of the term of this Agreement, but not otherwise, the provisions of this subsection 26A shall apply.

2. Premises to Which Applicable

The provisions of this subsection 26A shall be applicable only to premises which are owned by Dealer and carried on Dealer's books and records as land and building assets at the time that Dealer first has knowledge that a termination on one of the bases specified in subsection 26A1 above will become effective, and which are used by Dealer solely in the performance of Dealer's obligations under this Agreement, or solely in the performance of Dealer's obligations under this Agreement and one or more other dealer or distributor Agreements with Pontiac, Oldsmobile, Buick, Cadillac or GMC Truck & Coach Divisions of General Motors Corporation, if any, and such one or more other dealer or distributor Agreements are terminated simultaneously with the termination of this Agreement.

3. Chevrolet's Obligation

Upon the written request of Dealer made to Chevrolet within the time hereinafter specified, Chevrolet will assist Dealer in the orderly disposition of the aforesaid premises, to the end that the equities of Dealer will be protected, and Dealer will not suffer a loss on said premises in relation to the market value thereof as of the time of termination. In effecting such disposi-

tion of Dealer's premises under the provisions of this subsection 26A3 the following conditions shall apply:

(a) Dealer's application for assistance will include a written representation to Chevrolet of Dealer's intention to retire from the business of selling new or used motor vehicles in the general selling area wherein Dealer operated under this Selling Agreement.

(b) The assistance to be provided by Chevrolet hereunder will be in the form of either locating a purchaser who will offer to purchase Dealer's premises at a fair and reasonable price as hereinafter defined, or locating a lessee for Dealer who will offer to lease Dealer's premises for a reasonable term at a fair and reasonable rental as hereinafter defined. Moreover, if Chevrolet does not locate such a purchaser or lessee within a reasonable time, Chevrolet will offer either to purchase or lease Dealer's premises at such fair and reasonable purchase price or rental.

(c) In establishing fair and reasonable prices for Dealer's premises for the purpose of the sale or lease thereof, consideration will be given (i) to the circumstances under which the premises were originally provided by Dealer for the performance of this Selling Agreement or any prior Chevrolet Selling Agreement; (ii) to the adequacy of the premises for a Chevrolet Dealer Selling Agreement and the length of time such facilities have been used by Dealer in the performance of this Agreement or any other dealer or distributor Selling Agreement; and (iii) to the fair appraised value of the premises as determined by the average of the independent appraisals of three qualified real estate appraisers, of whom Dealer and Chevrolet shall each select one, and the two thus selected shall in turn select the third. Based on these considerations Dealer and Chevrolet shall agree upon a fair and reasonable purchase price and rental value for Dealer's premises.

(d) Upon receipt of a bona fide offer from a prospective purchaser or a prospective lessee, as the case may be, Dealer will sell Dealer's premises at the purchase price established as provided above or will lease Dealer's premises for a reasonable term at the rental established as provided above. The failure of Dealer to accept such a bona fide offer from a prospective purchaser or from a prospective lessee shall constitute a complete release of Chevrolet from any obligation to purchase or lease Dealer's premises as aforesaid and any other obligations under this subsection 26A.

(e) Any application for assistance from Chevrolet under the provisions of this subsection 26A must be made to Chevrolet in writing within thirty (30) days from the effective date of termination, and if Chevrolet does not receive a written application for such assistance

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within that time, Chevrolet shall be released from any and all obligations hereunder.

B. Premises Leased by Dealer

1. Terminations to Which Applicable

In the event of termination of this Agreement by Chevrolet under the provisions of subsection B(2) or B(3) of Section 23 hereof, or in the event Chevrolet terminates this Agreement because of Chevrolet's failure to secure or maintain any required license or renewal thereof as provided in subsection B(1) of Section 23 hereof, or in the event Chevrolet does not offer Dealer a new Selling Agreement upon the expiration of the term of this Agreement, but not otherwise, the provisions of this subsection 26B shall apply.

2. Premises to Which Applicable

The provisions of this subsection 26B shall be applicable only to premises leased by Dealer and used by Dealer solely in the performance of Dealer's obligations under this Agreement, or solely in the performance of Dealer's obligations under this Agreement and one or more other dealer or distributor Agreements with Pontiac, Oldsmobile, Buick, Cadillac or GMC Truck & Coach Divisions of General Motors Corporation, if any, and such one or more other dealer or distributor Agreements are terminated simultaneously with the termination of this Agreement; provided, moreover, that the premises involved shall have been leased by Dealer, and the lease or leases shall have been in effect, prior to the time Dealer had knowledge that a termination on one of the bases specified in subsection 26B 1 above would become effective, and the lease or leases of the premises shall continue subsequent to the effective date of termination of this Agreement.

3. Chevrolet's Obligation

Upon the written request of Dealer made to Chevrolet within the time hereinafter specified, Chevrolet will endeavor to assist Dealer in the liquidation of Dealer's obligation under any existing lease or leases of the aforesaid premises, to the end that the equities of Dealer will be protected and the normal losses incident to the liquidation of a business will be minimized. In providing such assistance to Dealer, the following conditions shall apply:

(a) Dealer's application for assistance will include a written representation to Chevrolet of Dealer's intention to retire from the business of selling new or used motor vehicles in the general selling area wherein Dealer operated under this Selling Agreement.

(b) The assistance to be provided by Chevrolet hereunder will be in the form of (i) locating a tenant or tenants, satisfactory to the Lessor or Lessors, who will offer to sublet the premises for the balance of the term of the lease or leases or who will take an assignment and assume the obligations of such lease or leases; or (ii) effecting arrangements satisfactory to Chevrolet and

the Lessor or Lessors whereby the lease or leases with Dealer will be cancelled; or (iii) the subletting by Chevrolet of the premises from Dealer, provided that the unexpired term of the lease or leases shall not be in excess of twelve (12) months from the effective date of termination of this Agreement. In the event Chevrolet does not locate a sublessee or assignee, or arrange for the cancellation of Dealer's lease or leases, or sublet the premises, as provided above, Chevrolet will pay as reimbursement to Dealer for the monthly rental specified in Dealer's lease and paid by Dealer for a period of twelve (12) months after the effective date of termination, or for the balance of the term of the lease, whichever shall be the lesser, (1) a fair monthly rental, as of the date of termination, as determined by three real estate appraisers, one selected by Chevrolet, one selected by Dealer and the third selected by the other two appraisers, or, at the option of Chevrolet, (2) the monthly rental specified in the lease.

(c) If, for a period of more than one (1) month immediately following the effective date of termination, the premises involved or any part thereof are occupied by Dealer or by anyone else for business or any other purpose, Chevrolet will be discharged from its obligation hereunder to reimburse Dealer for rental paid as aforesaid with respect to any month for any part of which the premises or any part thereof are so occupied; provided, however, that where the dealership premises consist of more than one parcel of property or more than one building, each of which is separately useable, distinct and apart from the whole premises or any other part thereof, with appropriate ingress and egress, each such parcel or building may be considered separately for the purpose of this subsection 26B3(c).

(d) If requested by Chevrolet, Dealer shall use its best efforts to effect a settlement of any lease or leases with the Lessor or Lessors to the same extent as if Chevrolet were not obligated, as provided herein, to assist Dealer in the liquidation of Dealer's obligations under any existing lease or leases, but any settlement shall be approved by Chevrolet before being finally accepted by Dealer. Any reduction in rental as a result of any such settlement shall proportionately reduce Chevrolet's obligation hereunder.

(e) If the premises involved are also used by Dealer in the performance of Dealer's obligations under one or more other dealer or distributor Agreements with Pontiac, Oldsmobile, Buick, Cadillac or GMC Truck & Coach Divisions of General Motors Corporation, which are terminated simultaneously with the termination of this Agreement, such other Division or Divisions of General Motors Corporation will arrange with Chevrolet as to which Division will

[fol. 489]

assume the obligations to Dealer under this subsection 26B, and Dealer will be so notified in writing.

(f) Upon receipt of a bona fide offer from a prospective tenant or tenants satisfactory to the Lessor or Lessors, Dealer will sublet Dealer's premises or assign the lease or leases thereon. In the event Chevrolet arranges a cancellation of the lease or leases on Dealer's premises without cost to Dealer, Dealer will execute a cancellation agreement with the Lessor or Lessors. The failure of Dealer to sublet the premises, to assign the lease or leases, to execute a cancellation agreement with the Lessor or Lessors or to use its best efforts if requested, to effect a settlement, all as provided above, shall constitute a complete release of Chevrolet from any further obligations under this subsection 26B.

(g) Any application for assistance from Chevrolet under the provisions of this subsection 26B must be made to Chevrolet in writing within thirty (30) days from the effective date of termination, and if Chevrolet does not receive a written application for such assistance within that time, Chevrolet shall be released from any and all obligations hereunder.

(h) In the event Dealer's obligations under existing leases are not otherwise liquidated and Dealer is entitled to reimbursement from Chevrolet under the provisions hereof for any rentals paid by Dealer, Dealer shall file its claim for such reimbursement with Chevrolet within two (2) months after the expiration of the period covered by such claim. Chevrolet shall have access to and may audit Dealer's books and records insofar as may be necessary to verify claims filed under this subsection 26B.

(i) The term "Dealer" as used herein shall be interpreted to include Dealer's executor(s), administrator(s) or representative(s) in the event the Selling Agreement is terminated in accordance with the provisions of subsection B(3) of Section 23 hereof.

C. Negotiations

The provisions of subsections 26A and 26B dealing as they do with situations as they will arise in the future must of necessity be stated in broad terms, and to accomplish the fair and equitable results intended all negotiations and transactions contemplated by subsections 26A and 26B will be carried on in the utmost of good faith on the respective parts of both Dealer and Chevrolet.

D. Termination Due to Death of Dealer

If this Agreement is terminated due to the death of Dealer or any person named in Paragraph Third hereof, Chevrolet, if requested to do so, and without assuming any legal obligations or liability with respect thereto, will render assistance to the representatives of the estate of Dealer in locating a purchaser or lessee for any premises owned by Dealer and used in the performance of Dealer's obligations under this Agreement at the time of said termination.

GENERAL PROVISIONS

27. Supplemental Provisions

In view of the extended term of this Agreement and the desire of Dealer and Chevrolet to keep the provisions hereof current with the distribution practices in the automobile industry, which practices may vary from time to time as the result of the enactment of federal or state laws or new or different interpretations by the courts or governmental agencies of existing laws, it is agreed that this Agreement may be supplemented at any time to include provisions relating to the general subject matters of "bootlegging", "territory security" and "service responsibility", as those terms have been used or interpreted by Congressional Committees or Subcommittees in hearings or in proposed legislation, provided that such supplemental provisions are incorporated in the Selling Agreements of all other Chevrolet dealers, in jurisdictions in which such provisions are not prohibited by state or local laws.

28. Dealer Not Made Agent or Legal Representative of Chevrolet

This Agreement of which these Terms and Conditions are a part does not constitute Dealer, the agent or legal representative of Chevrolet for any purpose whatsoever. Dealer is not granted any express or implied right or authority to assume or to create any obligation or responsibility in behalf of or in the name of Chevrolet or to bind Chevrolet in any manner or thing whatsoever.

29. Responsibility for Dealer's Commitments

Except insofar as it is specifically provided otherwise in this Agreement, Dealer shall be solely responsible for any and all obligations or responsibilities incurred or assumed by Dealer in the performance of this Agreement.

30. Local Taxes

Dealer hereby certifies that all motor vehicles and chassis, parts, accessories and items similar thereto purchased from Chevrolet are for resale in the course of Dealer's business. Dealer further certifies that Dealer has obtained any license required to collect sales or use taxes incurred in any such resale transactions, and that the number, if any, of such license has been or will be furnished to Chevrolet. Dealer agrees, as to any such motor vehicles and chassis, parts, accessories or items similar thereto which are withdrawn from stock and put to a taxable use in lieu of or prior to resale, and as to any tangible property which Dealer purchases for use and not for resale, to pay directly to the appropriate taxing authority any sales, use or similar taxes incurred by such use or purchase, to file any tax returns required in connection therewith, and to hold Chevrolet harmless from any claims or demands made by such taxing authority with respect thereto.

31. Notices

Any notice required to be given by either party to the other under or in connection with this Agreement shall be in writing and delivered personally or by mail. Notices to Dealer shall be directed to Dealer, or its representative at Dealer's place of business; notices to Chevrolet shall be directed to the Zone Manager of the area in which Dealer is located.

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32. No Implied Waivers

The failure of either party at any time to require performance by the other party of any provision hereof shall in no way affect the full right to require such performance at any time thereafter. Nor shall the waiver by either party of a breach of any provision hereof constitute a waiver of any succeeding breach of the same or any other such provision nor constitute a waiver of the provision itself.

33. Applicable Law

This Agreement is to be governed by and construed according to the laws of the State of Michigan. If, however, any provision in anywise contravenes the laws of any state or jurisdiction where this Agreement is to be performed, such provision shall be deemed not to be a part of this Agreement therein.

34. Sole Agreement of Parties

There are no other agreements or understandings, either oral or in writing, between the parties affecting this Agreement or relating to the sale or servicing of Chevrolet motor vehicles, chassis, parts or accessories.

This Agreement cancels and supersedes all previous agreements between the parties.

No change in, addition to, or erasure of any printed portion of this Agreement (except the filling in of blank lines) shall be valid or binding upon Chevrolet unless the same is approved in writing by the General Sales Manager of Chevrolet.

No agreement between the parties which is at variance with any of the provisions of this Agreement or which imposes definite obligations upon either party not specifically imposed by this Agreement or which is intended to be effective or performed following the expiration or other termination of this Agreement and imposes obligations or extends the time for performance thereof other than as provided in this Agreement shall be binding upon either party unless it bears the facsimile signature of the General Sales Manager and, except for Dealer Price Lists, is countersigned by an Assistant General Sales Manager, a Regional Manager, an Assistant Regional Manager or Zone Manager of Chevrolet, and is executed or accepted by Dealer.

[fol. 492]

PETITIONER'S EXHIBIT No. 4-d

FORM 673 11-50 -150-152
DISTRIBUTION RECORDS DEPT.

UMS

UNITED MOTORS SERVICE
DIVISION OF GENERAL MOTORS CORPORATION

UMS

WAREHOUSE DISTRIBUTOR AGREEMENT

This Agreement made in duplicate this.....day of.....19....., by and between General Motors Corporation, United Motors Service Division, a Delaware corporation, having its general offices at Detroit, Michigan, hereinafter called UMS (United Motors Service), and

Firm Name.....

Address.....
a (an) Corporation-Partnership-Individual, hereinafter called the WD (Warehouse Distributor);

Witnesseth:

WHEREAS, Warehouse Distributors are appointed by UMS as primary wholesale outlets for the sale and distribution of United Motors Service lines of products; and

WHEREAS, WD desires to be appointed by UMS as such a primary outlet on the United Motors Service line or lines of products designated below and will undertake to discharge all the obligations incident to such appointment; and

WHEREAS, UMS is agreeable to such appointment;

NOW, THEREFORE, in consideration of the premises, UMS hereby appoints WD a primary outlet and WD agrees to represent UMS as a Warehouse Distributor under the terms and conditions hereinafter set forth in this Agreement with respect to the following United Motors Service line or lines of products indicated below by a check mark ☒

Classification (S-P-PS)		AGREEMENT LINES
.....	1 ☐	Delco-Remy Electrical Parts
.....	2 ☐	New Departure Ball Bearings Hyatt Roller Bearings
.....	3 ☐	AC Speedometers, Gauges and Parts
.....	4 ☐	Harrison Radiators and Parts
.....	5 ☐	Delco Shock Absorbers and Parts
.....	6 ☐	Delco Electronic Parts
.....	7 ☐	Delco Batteries and Parts
.....	8 ☐	Guide Lamps and Parts
.....	9 ☐	Rochester Carburetors and Parts
.....	13 ☐	Harrison Thermostats
.....	16 ☐	Packard Cable Products
.....	17 ☐	Delco Hydraulic Brakes and Parts
.....	18 ☐	Delco Appliance Automotive Products
.....	37 ☐	Hydramatic Parts and Fluid
.....	☐	.....

SCOPE OF AGREEMENT

The term "line" or "lines" as hereafter used in this Agreement shall be deemed to refer only to the line or lines above designated by a check mark ☒ and the provisions of this Agreement are applicable only to such line or lines.

[fol. 493]

UMS AGREES:

PRICES AND TERMS OF SALE — 1. To sell to WD complete units, parts, equipment, accessories, and other material of each United Motors Service line designated above at the Warehouse Distributor prices issued by UMS and in effect at the time of shipment and subject to the regular UMS terms of payment.

SALES PROMOTION MATERIAL — 2. To provide WD with suitable signs, catalogs, price lists, printed forms and instructions to enable WD to promote sales and services on the lines covered by this Agreement with the understanding, however, that such material shall be applicable to and used by WD only to the extent that may be permitted by the law of the State or jurisdiction wherein this Agreement is to be performed.

WD AGREES:

INVENTORY REQUIRED — 3. To maintain an inventory of the line or lines covered by this Agreement properly assorted as determined by the experience of UMS and the usual demands of the area served by the WD and adequate in quantity to constitute a normal sixty-day supply.

MONTHLY ORDERS — 4. To order products from UMS at least once a month in standard package quantities and in sufficient quantity and variety for at least one month's normal needs and to cooperate with UMS in the use of such order forms as UMS may supply.

INVENTORY CHECK-UP — 5. To permit UMS representatives to check WD's stock records and/or inventory covering the material supplied by UMS in order to assist WD in maintaining inventories adequate in quantity and variety to supply the needs of the area served by WD.

PERSONNEL — 6. To employ both inside and outside salesmen, to provide coverage of the market, and to train such salesmen to recommend the proper application and use of the lines covered by this Agreement in order to effect the widest and best possible distribution thereof to the trade.

SALES PROMOTION — 7. To suitably identify his place of business as a wholesale outlet of UMS; display his UMS merchandise prominently; instruct his salesmen to work with UMS representatives; participate in UMS merchandising and service campaigns when so requested by UMS; assist UMS in analyzing the territory potential and coverage; report to UMS regularly on competitive conditions in WD's area and on any product complaints; conform to all sales and service policies of UMS and promote in every way practicable the sale of the lines covered by this Agreement.

REGISTRATION OF DEALERS — 8. To cooperate with United Motors Service in the registration as dealers of desirable retailers and to make regular contacts with such retailers to build up a market for the lines covered by this Agreement.

WARRANTY WORK — 9. To cooperate with UMS in fulfilling the service and warranty obligations of UMS on the lines covered by this Agreement.

SALES OF GENUINE UMS MATERIAL — 10. To sell as genuine parts and genuine complete units for the lines designated in this Agreement, only material supplied by UMS or by the Manufacturers whose trade-names are set forth in the "Agreement Lines" provision of this Agreement.

GENERAL — 11. To provide such other facilities and perform such other functions as are customary in the trade for a Manufacturer's primary wholesaler.

IT IS MUTUALLY AGREED:

CARRIER WD'S AGENT. — 12. That whenever UMS shall deliver to a common carrier any merchandise ordered by WD, whether the particular common carrier shall have been designated in the shipping or routing instructions of WD or not, UMS shall not be responsible for any delays or damages in shipment; and the common carrier to which such goods are delivered is hereby declared to be the agent of WD.

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WD NOT UMS' AGENT

13. That this Agreement does not constitute WD the agent or legal representative of UMS for any purpose whatsoever and that WD is not granted any right or authority to assume or create any obligation, expressed or implied, in behalf of or in the name of UMS or to bind UMS in any manner or thing whatsoever.

USE OF UMS NAME

14. (A) That UMS only is entitled to the use of the words "United Motors Service" and the United Motors Service emblems in connection with the sale and service of units, parts, equipment, accessories and other materials covered by this Agreement and to the good will attached thereto and that WD shall have the privilege of identifying his business with United Motors Service and shall enjoy the good will attached thereto only while this Agreement is in effect.

(B) That in the event of the termination of this Agreement for any reason or upon request of UMS, WD shall discontinue the use in any manner whatsoever of the UMS name, signs, or any other reference whatsoever to UMS, including any and all reference to the trade names and products designated in the "Agreement Lines" provision of this Agreement which would, in any way, imply or intimate that WD, in the conduct of his business, has any authorized or official position whatsoever with relation to UMS or the Manufacturers whose trade names are designated in the "Agreement Lines" provision of this Agreement or which might be likely to lead to confusion or uncertainty or to deceive the public. If WD, after termination of this Agreement or upon request of UMS as aforesaid, shall refuse or neglect to perform the provisions of this subparagraph (B), WD shall reimburse UMS for all costs, attorneys' fees and other expenses incurred by UMS in connection with legal action to require WD to comply therewith.

TERMINATION OF AGREEMENT

15. That this Agreement shall continue in full force and effect and govern all relations between the parties until terminated as hereinafter provided:

(A) Either party may terminate this Agreement, with or without cause, at any time by giving to the other party written notice of termination by registered mail or other means of delivery at least three (3) months prior to the effective date of such termination.

(B) UMS may terminate this Agreement immediately without any notice whatsoever to WD in the event of:

(1) Death, incapacity, or the removal, elimination, resignation or withdrawal from WD for any reason of the owner of or of any person owning a substantial interest in WD's business.

(2) Any dispute, disagreement, or controversy between or among partners, managers, officers, or stockholders of WD which, in the opinion of UMS, may affect adversely the ownership, operation, management, business, or interest of WD or UMS.

(3) Insolvency of WD; the filing of a voluntary petition in bankruptcy; the filing of a petition to have WD declared bankrupt; the appointment of a receiver or trustee for WD; the execution by WD of an assignment for the benefit of creditors; the conviction of WD or any principal, officer, or manager of WD of any crime which, in the opinion of UMS, may affect adversely the ownership, management, operation, business or interest of WD or UMS.

SHIPMENTS AFTER NOTICE OF TERMINATION

16. That in the event notice of termination has been given by either party to the other, UMS shall in no case be obligated to ship to WD in any one month for the succeeding three months more than the average of monthly purchases, by line, made by WD for the six-month period immediately preceding the date of notice of termination.

TERMS OF SALE AFTER NOTICE OF TERMINATION

17. That in the event notice of termination is given by either party to the other, UMS, at its option, may establish terms of cash with order or COD on any and all shipments thereafter made by UMS to WD.

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REPURCHASE OF PRODUCTS UPON TERMINATION

18. That in the event notice of termination of this Agreement is given to WD by UMS in accordance with Paragraph 15(A) above, WD may return to UMS for repurchase merchandise of any of the lines covered by this Agreement only with the prior written consent of UMS, and in the event of such consent, the obligation of UMS to repurchase such merchandise sold by it to WD shall be limited to:

(A) The repurchase at the list prices less discount or at the net prices in effect upon the date of notice of termination, less a 10% handling charge, of service parts or service units only invoiced to WD by UMS within the thirty (30) days immediately preceding the date of notice of termination, provided that such parts or service units are unused and undamaged and, if packaged items, are in the original container.

(B) The repurchase of other service parts and service units on the same basis as set forth in subparagraph (A) above in an amount equal only to that which WD would be privileged to return for credit under the inventory adjustment plan of UMS in effect upon the date of notice of termination. UMS, upon request of WD, will within thirty (30) days immediately following such request, advise WD of the amount of material which may be so returned.

(C) WD may return for credit or repurchase by UMS only such other materials and on such terms as may be mutually agreed upon and authorized in writing by UMS.

EFFECT OF TERMINATION UPON LIABILITIES

19. That termination of this Agreement for any reason shall not release WD from the payment of any sum which may be then owing to UMS and any sum or sums of money owing UMS by WD on the date of notice of termination shall become immediately due and payable.

APPLICABLE LAW

20. That this Agreement is to be governed by and construed according to the laws of the State of Michigan. If, however, any provision herein in any wise contravenes the laws of any state or jurisdiction wherein this Agreement is to be performed, such provision shall be deemed not to be a part of this Agreement therein.

PERSONAL AGREEMENT

21. That this Agreement constitutes a personal agreement and WD shall not transfer or assign the same or any part hereof or right or obligation arising hereunder without the written consent of UMS.

SOLE AGREEMENT OF PARTIES

22. That this Agreement cancels and supersedes all previous agreements, and understandings between the parties hereto pertaining to the purchase, sale of, or service on any and all United Motors Service lines and is the sole and only sales and service agreement existing by and between the parties hereto with respect to such lines; that this Agreement is entirely in printed form except for dates, names, places, classifications and signatures; and that any variation or modification hereof shall be established only by written agreement duly executed by both parties and attached hereto as a rider.

In Witness Whereof, the parties hereto have set their hands and seals effective as of the day and year first above written.

For the WD:

.....
Firm Name

By.....
Signature and Title

For UMS:

GENERAL MOTORS CORPORATION
UNITED MOTORS SERVICE DIVISION

.....
Recommended by: District Manager

.....
Approved by: Zone Manager

[fol. 496]

PETITIONER'S EXHIBIT No. 4-g

WAREHOUSE DISTRIBUTOR AGREEMENT

AC SPARK PLUG DIVISION
GENERAL MOTORS CORPORATION
FLINT, MICHIGAN

58

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FORM AC-901-58
9-58

AC SPARK PLUG DIVISION
GENERAL MOTORS CORPORATION

WAREHOUSE DISTRIBUTOR AGREEMENT

AGREEMENT made this _____ day of _____, 195__, by and between AC SPARK PLUG DIVISION, General Motors Corporation, of Flint, Michigan (hereinafter called AC), and

_____ of _____
(Insert exact individual, firm or corporate name) (Street Address)

_____ (hereinafter called "WD" that is, Warehouse Distributor),
(City) (State)

WITNESSETH:

WHEREAS, AC is engaged in the business of distributing certain automotive products manufactured by or for AC and bearing the trademark "AC" and/or other trademarks owned by General Motors Corporation; and

WHEREAS, WD desires to purchase such products from AC and to warehouse and deal in the same as a wholesaler to Jobbers and otherwise;

NOW, THEREFORE, in consideration of the premises and the mutual covenants hereinafter stated, it is mutually agreed as follows:

FIRST: AC will sell to WD and WD will buy from AC the following AC products indicated by checkmark:

	Line No.	
☐	1	AC Spark Plugs (Automotive not Aviation)
☐	2	AC Oil Filters and Elements
☐	3	AC Fuel Pumps (New) and Kits

The term "products" or "AC products" when used in this Agreement shall apply (a) as to Line No. 1, 2 and 3, only to those checked above, and (b) as to any other line or lines of products currently sold by AC, only to such as WD elects to purchase from AC.

[fol. 499]

SECOND: The Terms and Conditions set forth in "Terms and Conditions—Warehouse Distributor", bearing Form No. AC-810-58 are hereby made a part of this Agreement with the same force and effect as if set forth at length herein.

THIRD: This Agreement shall continue in force and govern all relations and transactions between the parties hereto from the date of execution hereof until terminated pursuant to the terms and provisions hereof.

FOURTH: This Agreement is not valid until and unless it bears the facsimile signature of the General Sales Manager and is countersigned by a Regional Manager of the AC Spark Plug Division—General Motors Corporation.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement in duplicate the day and year first above written.

AC SPARK PLUG DIVISION
GENERAL MOTORS CORPORATION

Distributor _____
Firm Name

E. N. Francoi
General Sales Manager

By _____
Title

By _____
Regional Manager

(If executed by representative of Distributor, title such as president, partner, etc., must be indicated.)

Town and State _____

Witness _____

If Distributor is a corporation, show state in which incorporated _____

[fol. 500]

FORM AC 810-58 8-58

AC SPARK PLUG DIVISION
GENERAL MOTORS CORPORATION

TERMS AND CONDITIONS

WAREHOUSE DISTRIBUTOR

The following Terms and Conditions have by reference been incorporated in and made a part of the Warehouse Distributor Agreement which shall apply to and govern all transactions, dealings and relations between the parties:

SELLING RIGHTS, TERMS AND CONDITIONS OF SALE

1. WD Selling Privilege

WD is granted the non-exclusive privilege of selling AC products and of using, in connection with said products, the name "AC" and certain trademarks owned by General Motors Corporation and used by it in connection with said products, including the trademarks "AC", "GM", "Guide" and distinctive design trademarks, all of which are herein referred to as "trademarks", which trademarks are acknowledged by WD to be the exclusive property of General Motors Corporation.

2. Prices

Sale of AC products to WD will be made at prices and on terms published by AC and in effect at the time of shipment.

3. Orders

WD shall endeavor to place its orders for AC products at least once a month in sufficient quantity and variety and in standard package quantities for at least one (1) month's normal needs, and to cooperate with AC in the use of order forms as AC may supply.

4. Failure or Delay in Shipments

AC shall not be liable for failure or delay in filling orders of WD, which have been accepted by AC, where such failure or delay is due, in whole or in part, to any labor, material, transportation, or utility shortage or curtailment, or to any labor trouble in the plants of AC or its suppliers, or to any cause beyond the control or without the fault or negligence of AC.

5. Right to Return Products Shipped in Error

WD may return AC products shipped in error for exchange or credit, provided WD presents his claim to AC within ten (10) days following receipt of shipment.

6. Return of Inactive Products

In the event WD develops an inactive stock of AC products, or for any reason desires to liquidate a portion of its stock of AC products, WD may submit to AC a list of those products purchased directly from AC, in good condition and unused, which WD desires to return for credit. AC shall promptly review said list and notify WD as to which products will be accepted and the proper shipping instructions. Following receipt of such written notification from AC, WD may package or crate and ship such products, transportation charges prepaid, in accordance with AC's instructions.

[fol. 501]

For such products returned by WD, AC will credit WD in accordance with the then current prices and terms as set forth in the then current Distributor Price and Terms Publication.

WD WHOLESALING REQUIREMENTS

7. Inventory Requirements

WD shall maintain an inventory of AC products properly assorted to meet the usual demands of the trade area served by the WD and adequate in quantity to constitute a normal sixty (60) day supply.

8. Examination of Inventory and Records

WD shall permit AC representatives to check, during normal business hours, WD's inventory and stock records covering AC products in order to assist WD in maintaining inventories adequate in quantity and variety to supply the needs of the trade area served by WD and to keep AC informed as to the movement of its products.

9. Personnel

WD agrees to employ both inside and outside salesmen to provide coverage of the market, and to train such salesmen to recommend the proper application and use of AC products in order to effect the widest and best possible distribution thereof to the trade.

10. Sales Promotion

WD agrees to suitably identify his place of business as a wholesale outlet of AC products; display AC merchandise prominently; illustrate AC products in his sales catalog; cooperate in AC merchandising and service campaigns; conform with the merchandising and service policies of AC; and promote in every way practicable the sale of AC products.

AC agrees to provide WD with suitable signs, catalogs, printed forms and instructions to enable WD to promote sales and services of AC products.

11. Market Development

WD shall assist AC in analyzing the potential and coverage of WD's trade area; report to AC regularly on competitive conditions in WD's trade area and on any AC product complaints; maintain regular contacts with trade, commercial and governmental accounts; and promote sale of AC products to such accounts by demonstrating application, use and advantages.

TERMINATION OF AGREEMENT

12. Termination By WD

WD may terminate this Agreement by written notice of termination delivered to AC, such termination to be effective upon receipt of notification by AC.

13. Termination by AC on One Month's Notice

AC may terminate this Agreement at any time by giving to WD written notice of termination one (1) month in advance of the effective date thereof.

14. Termination for Cause

AC may terminate this Agreement immediately by delivering to WD or its representative written notice of such termination in the event of the happening of any of the following: Insolvency of WD; the filing of a voluntary petition in bankruptcy by WD;

the filing of a petition to have WD declared bankrupt, provided it is not vacated within thirty (30) days from the date of filing; the appointment of a Receiver or Trustee for WD, provided such appointment is not vacated within thirty (30) days from the date of such appointment; the execution by WD of an assignment for the benefit of creditors; the conviction of WD or any principal officer, principal stockholder or manager of WD or any partner in WD or distributorship of any crime, which, in the opinion of AC, may adversely affect the good will or interests of WD, distributorship or AC.

15. Transactions after Termination

In the event this Agreement is terminated, all orders of WD for AC products then outstanding shall be cancelled automatically. Termination of this Agreement shall not release WD, however, from the obligation to pay any sum which may then be owing AC, nor does it release AC from the obligation to pay WD any sum owing to WD from AC.

16. Effect of Transactions after Termination

The acceptance of orders from WD or the continuance of sale of products to WD or any other act of AC after termination of this Agreement shall not be construed as a renewal of this Agreement for any further term nor as a waiver of the termination.

17. AC's Right to Repurchase on Termination

In the event this Agreement is terminated by AC, AC shall have the right to purchase from WD at the then current prices and terms as set forth in the then current Distributor Price and Terms Publication, new and undamaged AC products purchased by WD from AC, and which are in WD's possession on date of termination. Upon demand by AC and tender by AC of the purchase price determined as aforesaid, WD will ship such goods to AC forthwith in accordance with AC instructions, transportation charges prepaid. WD shall execute and deliver to AC any instruments necessary to convey title to the aforesaid property. If such property is subject to lien or charge of any kind, WD will procure the discharge and satisfaction thereof prior to the repurchase of such property by AC.

18. Discontinuance of Use of Trademarks

If the trademarks are used in any name under which WD's business is conducted or if said trademarks are used in any sign or advertising displayed by WD, WD will, upon request of AC or upon the termination of this Agreement, discontinue the use of said trademarks. Thereafter WD will not use or cause to be used either directly or indirectly, any of the said trademarks, or any other words, marks or designs confusingly similar to said trademarks, in a manner which is likely to lead to confusion, or uncertainty or to mislead the public; and if the said trademarks are used in any name under which WD's business is conducted, WD will promptly change the name eliminating the said trademarks therefrom.

If WD shall refuse or neglect to perform the provisions of this paragraph, WD shall reimburse AC for all costs, attorney fees, and other expenses incurred by AC in connection with legal action to require WD to comply therewith.

GENERAL PROVISIONS

19. WD not Made Agent or Legal Representative of AC

This Agreement of which these Terms and Conditions are a part does not constitute WD the agent or legal representative of AC for any purpose whatsoever. WD is not

[fol. 503]

granted any express or implied right or authority to assume or to create any obligation or responsibility in behalf of or in the name of AC or to bind AC in any manner or thing whatsoever.

20. Responsibility for WD's Commitments

Except insofar as it is specifically provided otherwise in this Agreement, WD shall be solely responsible for any and all obligations or responsibilities incurred or assumed by WD in the performance of this Agreement.

21. Local Taxes

WD hereby certifies that all products purchased from AC are for resale in the course of WD's business. WD further certifies that WD has obtained any license required to collect sales or use taxes incurred in any such resale transactions, and that the number, if any, of such license has been or will be furnished to AC. WD agrees, as to any such products which are withdrawn from stock and put to a taxable use in lieu of or prior to resale, and as to any tangible property which WD purchases for use and not for resale, to pay directly to the appropriate taxing authority any sales, use or similar taxes incurred by such use or purchase, to file any tax returns required in connection therewith, and to hold AC harmless from any claims or demands made by such taxing authority with respect thereto.

22. Notices

Any notice required to be given by either party to the other under or in connection with this Agreement shall be in writing and delivered personally or by certified mail. Notices to WD shall be directed to WD, or its representative, at WD's place of business; notices to AC shall be directed to the General Sales Manager, AC Spark Plug Division, General Motors Corporation, Flint, Michigan.

23. No Implied Waivers

The failure of either party at any time to require performance by the other party of any provision hereof shall in no way affect the full right to require such performance at any time thereafter. Nor shall the waiver by either party of a breach of any provision hereof constitute a waiver of any succeeding breach of the same or any other such provision nor constitute a waiver of the provision itself.

24. Applicable Law

This Agreement is to be governed by and construed according to the laws of the State of Michigan. If, however, any provision in anywise contravenes the laws of any state or jurisdiction where this Agreement is to be performed, such provision shall be deemed not to be a part of this Agreement therein.

25. Sole Agreement of Parties

There are no other agreements or understandings, either oral or in writing, between the parties affecting this Agreement or relating to the sale of AC products.

This Agreement cancels and supersedes all previous agreements between WD and AC Spark Plug Division, General Motors Corporation, relating to the purchase and sale of AC products.

No change in, addition to, or erasure of any printed portion of this Agreement (except the filling in of blank lines) shall be valid or binding upon AC unless the same is approved in writing by the General Sales Manager of AC.

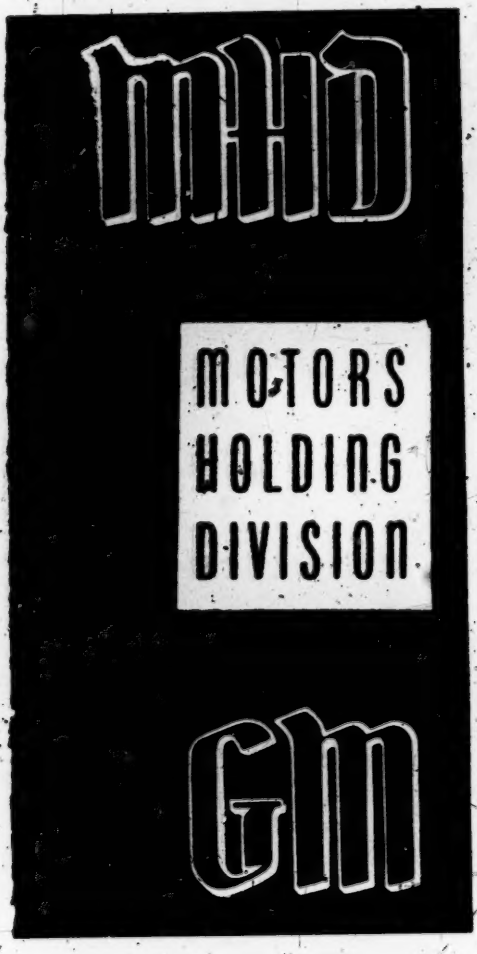
No agreement between the parties which is at variance with any of the provisions of this Agreement or which imposes definite obligations upon either party not specifically imposed by this Agreement or which is intended to be effective or performed following the expiration or other termination of this Agreement and imposes obligations or

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extends the time for performance thereof other than as provided in this Agreement shall be binding upon either party unless it bears the facsimile signature of the General Sales Manager and except for Distributor Price and Terms Publications, is countersigned by a Regional Manager, AC Spark Plug Division, General Motors Corporation, Flint, Michigan, and is executed or accepted by WD.

[fol. 505]

PETITIONER'S EXHIBIT No. 4-h



dealer investment plan

[fol. 507]

FOREWORD

The purpose of this pamphlet is to explain in broad outline the basic facts and principles underlying the Dealer Investment Plan of the Motors Holding Division, General Motors Corporation.

Specifically, this material explains why Motors Holding was organized, its objectives, how its Dealer Investment Plan operates so as to be of maximum assistance to General Motors Dealers, and the nature of the relations existing between Motors Holding and those Dealers using its Service.

m.h.d

MOTORS HOLDING DIVISION

g.m

GENERAL MOTORS CORPORATION

[fol. 508]

THE OPPORTUNITY AND THE OBJECTIVE

General Motors requires outlets for the sale of its various consumer products in all markets where those products are salable. In the case of its automotive products, that means practically everywhere. Its policy is to distribute such products through independent merchants, or dealers, who operate on their own capital for their own profit, in such a manner as they themselves may determine. Character, capacity, the willingness to work with the ambition to progress, as well as the requisite capital, have long been recognized as essential ingredients in the success of any business. The entire history of enterprise demonstrates the futility of expecting success where any one of these prime essentials is lacking to an important degree. And this particularly applies to the retailing of automobiles and commercial vehicles.

To synchronize these essential ingredients with the right location at the right time, and to do this on a broad scale, involves difficulties. It frequently happens that an individual offers the desirable personal qualifications, but through circumstances, is not in possession of adequate capital to finance a dealership

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properly. Thus, to promote ways and means of providing capital to those who can qualify appears to be both sound and desirable. Hence the need!

The recognition of the need led, in 1929, to the development of the Motors Holding Plan, now operated by the Motors Holding Division.

The objective is to assist in the development of quality dealers, adequately and independently financed and operated, wherever needed.

The plan was designed to provide a source of capital for eligible individuals on such a basis as would enable them, as a result of their own constructive efforts, ultimately to become independent merchants operating on their own capital created through the possibilities of the plan. It might well be said that General Motors could hardly use its resources to better purpose than by promoting its objectives through providing an opportunity for intelligent and ambitious employes of General Motors or its dealers or any other individuals to acquire for themselves a successful business and financial security.

In furtherance of this philosophy, the following three categories represent typical circumstances where Motors Holding capital frequently is desirable:

1. To supplement a prospective dealer's capital resources to enable him to establish a new dealership, either succeeding an existing dealer or at an open point.

2. To recapitalize an existing dealership in order to strengthen the company's financial position and thus enable the dealer to take full advantage of the market.

3. To enable a dealer to buy out inactive partners or to more efficiently reorganize his capital structure.

REQUIREMENTS FOR INVESTMENT

Candidates for an investment by Motors Holding are selected by the Car Divisions (Buick, Cadillac, Chevrolet, Oldsmobile, Pontiac, and GMC Truck), Frigidaire, Detroit Diesel and Euclid, on exactly the same basis as all potential General Motors dealers. Essential qualifications are: character, experience, ability and capacity to progress.

The basic requirements for an investment by Motors Holding are:

1. The dealer must be recommended by the Division having jurisdiction.

2. The dealer must have demonstrated sales and management ability.

3. The franchise must offer a satisfactory sales and profit potential.

4. The dealer must make a satisfactory investment, the exact amount of which will depend on the circumstances but

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in no case less than 25% of the total required capital.

5. The dealer must subscribe to sound merchandising policies based on the experience and practices of successful dealers. These principles have been summarized in "Policies of Motors Holding as a Stockholder in Dealership Corporations" issued by Motors Holding Division.

INVESTMENT PROCEDURE

Every effort is made to facilitate the prompt handling of an investment application. The normal procedure may be outlined as follows:

1. Applicants for Motors Holding investment service should first confer with the Car Division Zone Manager.
2. When a mutual agreement is reached between the applicant and the Car Division Zone Manager concerning an available car franchise, the Zone Manager submits a preliminary survey to his central office which recites the basic investment factors that must be considered.
3. Following the Car Division approval, this survey passes to General Motors Corporation Central Office for clearance.

4. Upon notice of clearance from General Motors Corporation Central Office, the local Motors Holding Branch Manager investigates the proposed investment and forwards the Investment Survey, along with his recommendations to the Motors Holding Executive Offices for final analysis and decision.

5. When the investment is approved, Motors Holding takes immediate action to have the new company organized and to consummate the completion of the investment. This generally requires only a few days and is finalized at the new dealer point by the Motors Holding representative in cooperation with the Dealer.

THE INVESTMENT PLAN

Dealer's Minimum Investment

The Dealer's initial investment must be a minimum of 25% of the total required capital of the dealership, it may be more—in fact, the dealer is expected to use all his available investment funds in the enterprise. Motors Holding provides the balance to adequately capitalise the dealership.

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When an investment is agreed upon, the Dealer is elected President and a Director of the company. He appoints all its personnel and is directly responsible for the management of the enterprise. Motors Holding retains voting stock control of the company during the period in which it owns stock.

The Dealer makes his investment in the dealer company by the purchase of $100 par Class B (non-voting) Stock. Motors Holding Division makes one-half of its investment in 6% long term notes and one-half through the purchase of $100 par Class A (voting) Stock. Shares of each class participate equally in profits on a per-share basis.

Dealer's Compensation and Profit Sharing Under the Plan

In addition to his salary for operating the dealership, the Dealer receives an annual cash bonus for successful management amounting to 33⅓% of the net profits of the dealer company in excess of 15% per annum on the total funds invested, including notes. This bonus is paid by the dealer company on a calendar basis and becomes a direct expense of the business.

A bonus will be paid for the first fractional year of operation if more than 15% per annum is realized on the total funds invested, including notes.

In addition to his salary and bonus, the Dealer is entitled to share, as a stockholder, in all net earnings of the company, INCLUDING THE FIRST 15%, simultaneously and proratably with Motors Holding on a per-share basis.

Example of Capital and Profit Distribution

To illustrate bonus calculation and profit distribution, the following example shows the results in a dealership having a total investment, including notes, of $100,000 ($62,500 stock and $37,500 notes), a minimum investment on the part of the Dealer of 25% and a year's profit, *after taxes, and interest on 6% notes and before bonus* of $36,000 or a 36% return.

	Stock Investment	*Number of Shares*	*% Stock Ownership*
Dealer—(Class B Stock)	$25,000	250	40%
M.H.D.—(Class A Stock)	37,500	375	60%
Total—Outstanding Stock	$62,500	625	100%

Distribution of Profits

Year's Profit of Company	$36,000
Dealer receives a bonus of 33⅓% of earnings above $15,000 (15% on total investment, including notes, of $100,000)	7,000
Year's Net Profit, *After Bonus*	$29,000
Dealer owning 40% of total capital stock receives 40% of Year's Net Profit, *After Bonus*	$11,600
Motors Holding owning 60% of total capital stock receives 60% of Year's Net Profit, *After Bonus*	17,400
Total	$29,000

Recapitulation

Dealer	
Bonus	$ 7,000
Equity in Stock Earnings	11,600
Total Dealer's Share	$18,600
M.H.D.	
Equity in Stock Earnings	17,400
Total	$36,000

If the Dealer invests more than 25% of the total required capital or as his equity in the dealer company increases, through the operation of the Plan, his share of the earnings increases.

For example: using a $100,000 company with annual earnings (after taxes and after interest on 6% notes) of $36,000 with the dealer's investment 50% of the total capital, the distribution of earnings would be as follows:

	Dealer	*M.H.D.*	*Total*
Stock Investment	$50,000	$25,000	$75,000
Earnings:			
Bonus	$ 7,000	None	$ 7,000
Allocation First 15% of Earnings	10,000	$ 5,000	15,000
Allocation Balance of Earnings remaining after Bonus	9,333	4,667	14,000
Total Earnings	$26,333	$ 9,667	$36,000

Distribution of Losses

In the event of losses in the dealership, such losses up to 15% of the total outstanding stock are shared proratably based on stock holdings, by Motors Holding and the Dealer. Losses above an amount equal to 15% of the total outstanding stock are assumed by the Dealer up to the amount of his investment.

Option Agreement

At the time Motors Holding makes an investment in a dealership, it enters into an agreement with the Dealer which provides, among other things:

1. That the Dealer shall have the option to purchase Motors Holding's stock in the dealership from his dividends and bonus funds. In fact, to assure the prompt acquisition of its stock, the agreement requires that he use all of his dividends and at least one-half of his bonus funds for this purpose.

2. That when M.H.D.'s stock interest has been reduced to 20% of the stock purchased by it, if there are any notes outstanding in the hands of M.H.D., they must be retired by the dealer company and/or purchased by the dealer before the balance of M.H.D.'s stock may be reduced.

3. That in the event the Dealer's connection with the dealership is terminated by incapacity, death, resignation, or removal, Motors Holding Division will, if the dealer company is to continue in business, purchase his stock and dealer company notes. In the event the dealership is discontinued, the Dealer is paid his share of the proceeds in liquidation.

The latter provision insures the Dealer prompt and full settlement for his interest and, in the event of his decease, usually relieves his estate of the necessity of liqui-

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dating with the inevitable heavy dissipation of assets.

Additional Information

The fact that Motors Holding Division is a part of General Motors Corporation in no way affects the status or relationship of the Dealer with respect to his responsibilities under the franchise.

The President, who is always the Dealer, is elected chief executive officer with full power and authority to administer the affairs of the company in accordance with the policies adopted by the Directors.

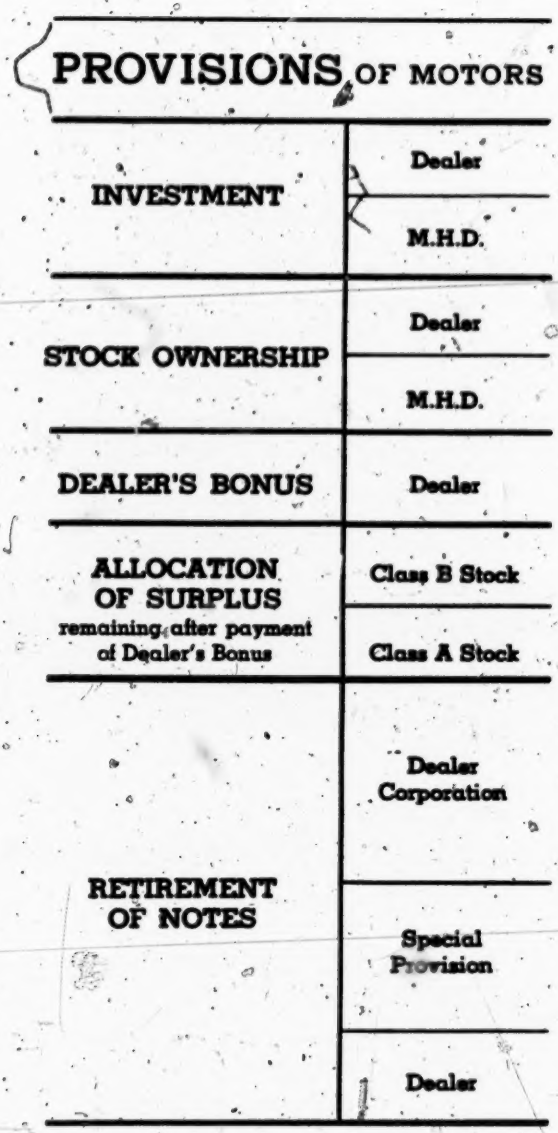
The Secretary-Treasurer is responsible for maintaining the company's records and accounts.

The President appoints all but the elected personnel and, as chief executive officer, is wholly responsible for securing a proper sales and service volume and a satisfactory net profit.

When Motors Holding has an investment, the dealership is assured of adequate capital to meet all necessary requirements. Should the initial investment prove insufficient, additional capital is available if the need for it is indicated.

Following an investment by Motors Holding, its representatives maintain frequent contact with the Dealer for the purpose of counseling with him with respect to the financial and operating problems of the dealership.

Motors Holding Division, General Motors Corporation, reserves the right to make changes in its Dealer Investment Plan at any time without notice.


PROVISIONS OF MOTORS
INVESTMENT
Dealer
M.H.D.
STOCK OWNERSHIP
Dealer
M.H.D.
DEALER'S BONUS
Dealer
ALLOCATION OF SURPLUS
remaining after payment of Dealer's Bonus
Class B Stock
Class A Stock
RETIREMENT OF NOTES
Dealer Corporation
Special Provision
Dealer

[fol. 519]

HOLDING INVESTMENT PLAN

Required to invest at least 25% of total capital, in Class B (non-voting) Stock.
Invests balance up to 75% of required capital, equally divided between 6% notes and Class A (voting) Stock.
$100 par (non-voting) Class B Stock.
$100 par (voting) Class A Stock.
Receives a bonus of one-third of net profits, after taxes, above 15% per year on the funds invested, including notes.
Participates proratably with Class A Stock.
Participates proratably with Class B Stock.
45% of each calendar year's earnings available for dividends, or the amount required to pay off the notes entirely, whichever is the lesser, *must* be used, and not later than January 15th of the ensuing year, to retire notes until M.H.D.'s stock interest has been reduced to 20% of the stock purchased by it. Thereafter, up to 70% of the earnings *may* be used to retire notes. The balance will be available for dividends of which the operator *may* use his share to purchase notes held by M.H.D.
When M.H.D.'s stock interest has been reduced to 20% of the stock purchased by it, if it then holds any notes of Dealer Company, they must be retired by the dealer company and/or purchased by the dealer before the balance of M.H.D.'s stock may be reduced.
May purchase notes from M.H.D. with his earnings from the dealer company, when special provision applies.

PROVISIONS OF MOTORS

RETIREMENT OF M.H.D.'S STOCK INTEREST	Dealer Corporation	Concurrently with the retirement of notes, unless the 20% special provision applies, 25% of earnings available for distribution is to be used to retire Class A Stock when the remaining 30% is simultaneously distributed as dividends. When there are no notes outstanding, 50% of available earnings is to be used to retire Class A Stock when the remaining 50% is simultaneously distributed as dividends.
	Dealer	Required to use at least 50% of his bonus and all of his dividends for the purchase of M.H.D.'s Class A Stock, subject to minimum stock retention by M.H.D., which stock must be immediately converted into Class B Stock.
ALLOCATION OF LOSSES (DEFICIT)	Class B Stock	Shares proratably with Class A Stock in deficits up to 15% of total outstanding Capital Stock and thereafter to full extent of its par value.
	Class A Stock	Shares proratably with Class B Stock in deficits up to 15% of total outstanding Capital Stock.

m.h.d

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HOLDING INVESTMENT PLAN

y.m

15

was paid to respondent by petitioner under written protest (copy attached as Exhibit 10-J) on May 19, 1960. Additional interest thereon of $138.10 was paid to respondent by petitioner under written protest (copy attached as Exhibit 11-K) on May 20, 1960. A copy of the receipt for payment of the foregoing taxes, plus interest, for 1958 is attached as Exhibit 12-L.

15. These proceedings, being Docket Numbers 1698 and 1699, were timely commenced on May 23, 1960, before the District of Columbia Tax Court. Amended petitions were timely filed on June 13, 1960.

Dated March 29, 1961.

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ATTACHMENTS TO NUMBERS STIPULATION

EXHIBIT 3-C TO NUMBERS STIPULATION

	Sales Determined by the Finance Officer To Be District Sales				Sales of Goods Billed to Customers at Offices Within the District of Columbia Which Were Shipped From Stocks Outside the District to Points Outside the District				Sales of Goods Shipped From Stocks Outside the District to Points Within the District			
	U.S. Government	Other	Total	Tax Effect	U.S. Government	Other	Total	Tax Effect	U.S. Government	Other	Total	Tax Effect
AC Spark Plug	$ 429	$ 145,094	$ 145,523	$ 1,009.06	$ -	$ -	$ -	$ -	$ 429	$ 145,094	$ 145,523	$ 1,009.06
Allison	3,242	-	3,242	22.48	-	-	-	-	3,242	-	3,242	22.48
Buick Motor	2,161	3,861,841	3,864,002	26,792.99	-	-	-	-	2,161	3,861,841	3,864,002	26,792.99
Cadillac Motor Car	9,399	5,913,280	5,922,679	41,067.86	-	227,594	227,594	1,578.14	9,399	5,685,686	5,695,085	39,489.72
Chevrolet Motor	1,080,362	14,119,113	15,199,475	105,394.25	572,767	119,876	692,643	4,802.85	507,595	13,999,237	14,506,832	100,591.40
Cleveland Diesel Engine	139,035	-	139,035	964.07	137,698	-	137,698	954.80	1,337	-	1,337	9.27
Delco Appliance	217	43,927	44,144	306.09	-	-	-	-	217	43,927	44,144	306.09
Delco Products	46	26,524	26,570	184.24	-	-	-	-	46	26,524	26,570	184.24
Delco Radio	13,699	1,115	14,814	102.72	-	-	-	-	13,699	1,115	14,814	102.72
Delco-Remy	-	21,291	21,291	147.63	-	-	-	-	-	21,291	21,291	147.63
Detroit Diesel Engine	99,764	27,192	126,956	880.31	95,615	-	95,615	662.99	4,149	27,192	31,341	217.32
Electro-Motive	-	213,701	213,701	1,481.80	-	-	-	-	-	213,701	213,701	1,481.80
Foreign Distributors	-	14,007	14,007	97.12	-	-	-	-	-	14,007	14,007	97.12
Frigidaire	-	805,031	805,031	5,582.08	-	805,031	805,031	5,582.08	-	-	-	-
GM Truck & Coach*	-	1,249,930	1,249,930	8,667.01	-	-	-	-	-	1,249,930	1,249,930	8,667.01
Guide Lamp	-	747	747	5.18	-	-	-	-	-	747	747	5.18
Harrison Radiator	1,790	1,550	3,340	23.16	-	-	-	-	1,790	1,550	3,340	23.16
Hyatt Bearings	26	3,426	3,452	23.94	-	-	-	-	26	3,426	3,452	23.94
Inland Manufacturing	-	58	58	.40	-	-	-	-	-	58	58	.40
New Departure	7,395	2,242	9,637	66.82	-	-	-	-	7,395	2,242	9,637	66.82
Oldsmobile	-	5,851,855	5,851,855	40,590.63	-	-	-	-	-	5,851,855	5,851,855	40,590.63
Packard Electric	184,437	1,934	186,371	1,292.30	184,437	1,005	185,442	1,285.86	-	929	929	6.44
Pontiac Motor	2,650	4,877,021	4,879,671	33,835.64	-	-	-	-	2,650	4,877,021	4,879,671	33,835.64
Saginaw Steering Gear	10,902	630	11,532	79.96	9,565	630	10,195	70.69	1,337	-	1,337	9.27
United Motors Service	-	600,359	600,359	4,166.36	-	-	-	-	-	600,359	600,359	4,166.36
Total	$1,555,554	$37,784,368	$39,339,922	$272,784.10	$1,000,082	$1,154,136	$2,154,218	$14,937.41	$ 555,472	$36,630,232	$37,185,704	$257,846.69
* GMC - Truck Sales		731,058	731,058							731,058	731,058	
GMC - Coach Sales		518,872	518,872							518,872	518,872	



branch offices

ATLANTA 3, GEORGIA
603 Rhodes-Haverty Bldg.
134 Peachtree Street, N. W.

BOSTON 16, MASSACHUSETTS
908 Park Square Bldg.
31 St. James Avenue

BUFFALO 2, NEW YORK
1808 Liberty Bank Building
420 Main Street

CHARLOTTE 3, NORTH CAROLINA
Room 308
1031 East Morehead Street

CHICAGO 11, ILLINOIS
606 Palmolive Building
919 North Michigan Avenue

CINCINNATI 2, OHIO
2410 Kroger Building
1014 Vine Street

CLEVELAND 15, OHIO — No. 1
Room 309
3101 Euclid Avenue

CLEVELAND 15, OHIO — No. 2
Room 208
3101 Euclid Avenue

DALLAS 4, TEXAS
211 Sanford-Maple Bldg.
2818 Maple Avenue

DENVER 2, COLORADO
1108 Denver Club Building
518 - 17th Street

DETROIT 2, MICHIGAN — No. 1
10-247 General Motors Bldg.
3044 West Grand Blvd.

DETROIT 2, MICHIGAN — No. 2
10-248 General Motors Bldg.
3044 West Grand Blvd.

HOUSTON 4, TEXAS
301 Old National Bldg.
2619 Fannin Street

INDIANAPOLIS 4, INDIANA
804 Fidelity Bldg.
111 Monument Circle

KANSAS CITY 6, MISSOURI
1020 Power & Light Bldg.
100 West 10th Street

LOS ANGELES 5, CALIFORNIA — No. 1
812-13 Tishman Building
3325 Wilshire Boulevard

LOS ANGELES 5, CALIFORNIA — No. 2
812-13 Tishman Building
3325 Wilshire Boulevard

MINNEAPOLIS 2, MINNESOTA
2118 Foshay Tower Building
9th at Marquette

NEW YORK 19, NEW YORK
921 General Motors Bldg.
1775 Broadway

PITTSBURGH 22, PENNSYLVANIA
726 One Gateway Center
420 Fort Duquesne Blvd.

ST. LOUIS 5, MISSOURI
906 Sisseman Building
111 South Bemiston Avenue

SAN FRANCISCO, CALIFORNIA
132 North El Camino Real
San Mateo, California

WASHINGTON, D. C.
223 Guardian Federal Bldg.
Silver Spring, Maryland



MOTORS HOLDING DIVISION
EXECUTIVE OFFICES
GENERAL MOTORS BUILDING
DETROIT 2, MICHIGAN

Option Agreement

between . . .

GENERAL MOTORS CORPORATION
MOTORS HOLDING DIVISION

and . . .

OPERATOR

DATED 19

GENERAL MOTORS CORPORATION
MOTORS HOLDING DIVISION
GENERAL MOTORS BUILDING DETROIT 2, MICHIGAN

Option Agreement

AGREEMENT made on....., 19....

by and between

General Motors Corporation (Motors Holding Division), "Investor" AND .....

"Operator"

WITNESSETH:

WHEREAS Investor has purchased and is the owner of all the issued and outstanding shares of the Class "A" Stock of .....

.....

....."Dealer Company", and

WHEREAS Operator has purchased and is the owner of all the issued and outstanding shares of the Class "B" Stock of Dealer Company, and

WHEREAS the parties desire to provide for the purchase of their respective Stock interests in Dealer Company,

NOW, THEREFORE, it is agreed that:

[fol. 540]

ATTACHMENTS TO NUMBERS STIPULATION

EXHIBIT 3-C TO NUMBERS STIPULATION

[fol. 525]

ARTICLE I Purchase of Investor's Stock

Investor hereby gives to Operator the right to purchase any number of full shares of Stock held by Investor under the following conditions:

A. **SOURCE OF FUNDS**—The purchase shall be made only from funds received by Operator as dividends or bonus from Dealer Company.

B. **PURCHASE PRICE**—Operator shall pay the book value, computed under Article X, from the balance sheet of Dealer Company, prepared as of the Date of Purchase, less any dividends declared and paid on such Stock between the date of the balance sheet and the date of actual purchase.

C. **DATE OF PURCHASE**—When the source of funds used by Operator to purchase Stock from Investor is dividends received by Operator from Dealer Company, the date of purchase shall be as of close of business on the last day of the calendar month preceding the month in which Investor receives the purchase price at its offices in Detroit, Michigan, provided such receipt is on or before the fifteenth day of the month. In all other cases, it shall be as of the close of business on the last day of the month of receipt.

When the source of funds used by Operator to purchase Stock from Investor is bonus received by Operator from Dealer Company, the date of purchase shall be as of the close of business on December 31 of the year whose earnings are used to calculate the amount of said bonus regardless of the date on which such funds are received by Operator or the date on which such funds are received by Investor from Operator.

D. **PLACE OF SALE**—It is understood that all sales are made at the offices of Investor in Detroit, Michigan.

ARTICLE II Dividends and Bonus Funds

Operator agrees that during the period of the option granted him in Article I:

A. He will use all dividends received on his Stock and at least one-half of any bonus received by him from Dealer Company to purchase Investor's Stock;

B. He will immediately convert any Class "A" Stock which he purchases from Investor into Class "B" Stock.

C. The amount of the bonus he receives from Dealer Company which he desires to transmit to Investor for the purchase of Investor's Stock hereunder (which in no event will be less than ½ of the total amount of bonus he receives from Dealer Company) will be transmitted to Investor no later than five days after the receipt of such bonus by Operator.

[fol. 541]

ATTACHMENTS TO NUMBERS STIPULATION
EXHIBIT 4 TO NUMBERS STIPULATION

(See Opposite) ☞

ARTICLE III Termination or Suspension of Operator's Option

A. **TERMINATION**—The right granted Operator under Article I shall automatically expire when and if Operator ceases, for any reason, to be President of Dealer Company. If the right granted Operator under Article I hereof is terminated then, within ninety days thereafter, Investor shall advise Operator either that:

1. Investor will purchase Operator's Stock; or,

2. Investor will request the Board of Directors of Dealer Company to take the necessary steps to liquidate the affairs of Dealer Company and distribute the proceeds to its stockholders.

B. **SUSPENSION**—When the number of shares of Stock held by Investor has been reduced to 20% of the total number of shares of Stock theretofore purchased by Investor, the right granted Operator under Article I shall automatically be suspended if and so long as Investor is the holder of any Long Term Indebtedness of Dealer Company.

ARTICLE IV Purchase of Operator's Stock

If Investor advises Operator, under Article III, that it will purchase Operator's Stock, then—

A. Operator shall sell to Investor and Investor shall purchase from Operator all of his Stock in the following manner:

1. The Stock shall be sold at its audited book value, computed under Article X, from the balance sheet of Dealer Company, prepared as of the end of the calendar month in which Operator's right under Article I was terminated, less any dividends declared and paid on such Stock between the date of the balance sheet and the date of actual purchase.

2. The audited book value of the Stock shall be determined by Dealer Company's auditor, who, if any assets are overstated, is authorized for this purpose to make such adjustments as in his judgment are necessary or proper to reflect the true value of such Stock. The auditor's decisions, made in good faith, shall be final and conclusive.

3. If the audited book value of Operator's Stock is zero, Investor shall pay Operator One Dollar ($1.00) for all of his Stock.

4. The purchase price of the Stock shall be paid or tendered to Operator by Investor within thirty days after Investor is advised in writing of the audited book value of the Stock. Such payment or tender shall be made by delivery at or mailing to Operator's last known address. Operator shall thereupon immediately deliver to Investor (properly assigned and without further cost to Investor) the certificates for the Stock.

B. Operator shall assign to Investor and Investor shall purchase from Operator any Long Term Indebtedness held by Operator with interest calculated to the date payment or tender of payment is made by Investor. The payment or tender may be

[fol. 527]

made by delivery at or mailing to Operator's last known address. Operator shall thereupon deliver to Investor (properly assigned and without further cost to Investor) all evidence of such indebtedness. The payment or tender hereunder shall be made no later than the payment or tender for Operator's Stock under Section A of this Article IV.

ARTICLE V Liquidation of Dealer Company

If Investor advises Operator under Article III that it will request the liquidation of the affairs of Dealer Company, then the parties shall cooperate, each with the other, in expediting the necessary steps to liquidate the affairs of and dissolve Dealer Company so that the parties may receive their respective shares of the proceeds of such liquidation as quickly as possible.

ARTICLE VI Undisclosed or Unrecorded Liabilities

If Investor shall have purchased and paid for Operator's Stock under Article IV and there subsequently appear any undisclosed or unrecorded liabilities of Dealer Company properly applicable to or deriving from a period of time prior to the date as of which the book value of Operator's Stock was computed, then, upon demand by Investor, Operator shall repay to Investor the amount by which Investor overpaid Operator by reason of the omission of such undisclosed or unrecorded liabilities. Any expense or loss arising out of any act of commission or omission, authorized or unauthorized, of Dealer Company or its agents prior to the date as of which the book value was computed shall also be deemed to be undisclosed or unrecorded liabilities if such expense or loss is not reflected in the books of Dealer Company as of such date.

ARTICLE VII Assignments

Investor shall have the right to transfer and assign this agreement provided all shares of Stock then held by Investor are also transferred or assigned and provided its assignees or transferees assume the obligations and liabilities herein imposed upon Investor.

Operator agrees that so long as Investor is a stockholder in Dealer Company he will not sell, assign, hypothecate, transfer or otherwise dispose of any portion of any Stock or Long Term Indebtedness held by Operator without the written consent of Investor.

ARTICLE VIII Accounting Decisions

The accounting system and accounting procedures adopted from time to time by the Board of Directors of Dealer Company shall govern in determining the book value of Stock to be sold hereunder.

The book value of the Class "A" and/or Class "B" Stock shall, in the event of a disagreement between the parties, be decided by Dealer Company's auditor. The auditor's decision, made in good faith, shall be final and conclusive.

	Sales Determined by the Finance Officer To Be District Sales				Sales of Goods Billed to Customers at Offices Within the District of Columbia Which Were Shipped From Stocks Outside the District to Points Outside the District				Sales of Goods Shipped From Stocks Outside the District to Points Within the District			
	U.S. Government	Other	Total	Tax Effect	U.S. Government	Other	Total	Tax Effect	U.S. Government	Other	Total	Tax Effect
AC Spark Plug	$ 36,295	$ 625,484	$ 661,779	$ 2,752.88	$ -	$ -	$ -	$ -	$ 36,295	$ 625,484	$ 661,779	$ 2,752.88
Allison	16,232	1,452	17,684	73.56	-	-	-	-	16,232	1,452	17,684	73.56
Buick Motor	1,307	2,409,758	2,413,065	10,037.92	-	-	-	-	1,307	2,409,758	2,413,065	10,037.92
Cadillac Motor Car	18,570	4,989,355	5,007,925	20,832.07	-	1,725,181	1,725,181	7,176.44	18,570	3,264,174	3,282,744	13,655.63
Chevrolet Motor	6,577,594	12,548,524	19,126,118	79,561.22	5,735,781	42,363	5,778,144	24,036.04	841,813	12,506,161	13,347,974	55,525.18
Cleveland Diesel Engine	477,677	616	478,293	1,989.61	477,655	-	477,655	1,986.96	22	616	638	2.65
Delco Appliance	-	38,830	38,830	161.53	-	-	-	-	-	38,830	38,830	161.53
Delco Products	104	35,112	35,216	146.49	-	-	-	-	104	35,112	35,216	146.49
Delco Radio	24,714	6,351	31,065	129.22	-	-	-	-	24,714	6,351	31,065	129.22
Delco-Remy	716	20,677	21,393	88.99	-	-	-	-	716	20,677	21,393	88.99
Detroit Diesel Engine	2,299	7,937	10,236	42.58	-	-	-	-	2,299	7,937	10,236	42.58
Electro-Motive	-	148,587	148,587	618.10	-	-	-	-	-	148,587	148,587	618.10
Foreign Distributors	-	31	31	.13	-	-	-	-	-	31	31	.13
Frigidaire	-	19,944	19,944	82.96	-	19,944	19,944	82.96	-	-	-	-
GMC Truck & Coach *	27,126	4,324,561	4,351,687	18,102.23	27,126	-	27,126	112.84	-	4,324,561	4,324,561	17,989.39
GM Overseas Operations	-	230	230	.96	-	-	-	-	-	230	230	.96
Harrison Radiator	-	729	729	3.03	-	-	-	-	-	729	729	3.03
Hyatt Bearings	949	5,694	6,643	27.63	-	-	-	-	949	5,694	6,643	27.63
Inland Manufacturing	-	431	431	1.79	-	-	-	-	-	431	431	1.79
New Departure	7,970	1,530	9,500	39.52	-	-	-	-	7,970	1,530	9,500	39.52
Oldsmobile	-	4,580,899	4,580,899	19,055.71	-	-	-	-	-	4,580,899	4,580,899	19,055.71
Packard Electric	48,575	2,076	50,651	210.70	48,575	28	48,603	202.18	-	2,048	2,048	8.52
Pontiac Motor	3,482	2,916,305	2,919,787	12,145.79	-	-	-	-	3,482	2,916,305	2,919,787	12,145.79
Saginaw Steering Gear	3,353	-	3,353	13.95	-	-	-	-	3,353	-	3,353	13.95
United Motors Service (1/1 - 6/30)	-	295,687	295,687	1,230.00	-	-	-	-	-	295,687	295,687	1,230.00
United Motors Service (7/1 - 12/31)	-	389,409	389,409	1,619.87	-	-	-	-	-	389,409	389,409	1,619.87
Total	$7,248,963	$33,370,209	$40,619,172	$166,966.44	$6,289,137	$1,787,516	$8,076,653	$ 33,577.42	$ 959,826	$31,582,693	$32,542,519	$135,371.02
* GMC - Truck Sales	6,021	1,287,455	1,293,476		6,021	--	6,021		-0-	1,287,455	1,287,455	
GMC - Coach Sales	21,105	3,037,106	3,058,211		21,105	--	21,105		-0-	3,037,106	3,037,106	

[fol. 528]

ARTICLE IX Voting Stock

The parties recognize that Investor owns all the voting Stock and may use such voting power to remove Operator as a Director and to cause his removal as President of Dealer Company. Nothing in this agreement shall affect this right or any other rights which Investor may have by reason of its voting control of Dealer Company.

ARTICLE X Basis For Determining Book Value

The per share book value of the Class "A" and Class "B" Stock outstanding on a given date will be ascertained by whichever of the following three computations shall be appropriate:

A. If the net worth of Dealer Company as of such date is equal to or exceeds 85% of the aggregate par values of all its outstanding shares of Stock: By dividing the amount of such net worth by the total number of all outstanding Shares.

B. If the net worth of Dealer Company as of such date is less than 85% of the aggregate par values of all its outstanding Shares, but more than 85% of the aggregate par value of all the outstanding Class "A" shares of Stock, each Class "A" Share shall have a book value of $85.00, and the then remaining net worth shall be divided by the number of Class "B" Shares outstanding to determine the book value of each Class "B" Share.

C. If the net worth of Dealer Company as of such date is less than 85% of the aggregate par values of all its outstanding Shares, and is also less than 85% of the aggregate par values of all outstanding shares of Class "A" Stock, the book value of each Class "A" Share shall be determined by dividing such net worth by the total number of Class "A" Shares outstanding, and the book value of each Class "B" Share shall be zero.

The balance sheet to be used for the above computations shall, at the election of the seller of the Stock, be one audited by Dealer Company's auditor.

ARTICLE XI Other Terms and Conditions

The terms "Stock", "Shares", "Class 'A' Stock", and "Class 'B' Stock" refer to Shares of Dealer Company Stock and include any such Shares now held or hereafter acquired by the parties, but excludes any such Shares sold to or redeemed by Dealer Company.

"Long Term Indebtedness" shall mean any indebtedness of Dealer Company (as a principal and not as a surety or guarantor) having a maturity date at the time of the creation of the indebtedness of more than 18 months.

The waiver by Investor in any one or more instances of any covenants of this Agreement to be performed by Operator shall not be construed as a waiver of such covenants for the future, and said covenants shall continue in full force and effect.

This Agreement consisting of 6 pages shall be binding upon the parties, their respective heirs, executors, administrators, successors, legal representatives and assigns. No change hereof shall be valid unless made in a writing executed in the same manner as this agreement.

3-80—500 PRINTED IN U. S. A.

[fol. 529]

IN WITNESS WHEREOF this agreement has been executed and delivered in duplicate at Detroit, Michigan, the day and year first above written.

GENERAL MOTORS CORPORATION
MOTORS HOLDING DIVISION

ATTEST

Assistant Secretary

By

Witness

Operator

L.S.

[fol. 530]

BEFORE THE DISTRICT OF COLUMBIA TAX COURT

NUMBERS STIPULATION—March 29, 1961

The parties by their respective counsel stipulate and agree as follows:

1. These cases may be consolidated for trial.

2. Petitioner is a corporation organized and existing under and by virtue of the laws of the State of Delaware, having its principal office at 3044 West Grand Boulevard, Detroit 2, Michigan. Petitioner on December 21, 1954, obtained a certificate of authority to do business in the District of Columbia, and such certificate remains in full force and effect.

3. Petitioner duly filed on October 13, 1958, its District of Columbia Franchise Tax Return for the calendar year 1957, respondent having extended the time for filing to October 15, 1958, and reported tax liability in the amount of $4,198.70, computed as follows:

Net Income to Be Apportioned		$1,312,092,839.15
Apportionment Formula:		
District Sales	$ 600,859	.0064%
Total Sales	$9,461,855,874	
Net Taxable Income		$ 83,973.94
Tax at 5%		$ 4,198.70

4. Petitioner duly filed on October 7, 1959, its District of Columbia Franchise Tax Return for the calendar year 1958, respondent having extended the time for filing to October 15, 1959, and reported tax liability in the amount [fol. 531] of $1,241.45, computed as follows:

Net Income to Be Apportioned		$653,396,893.13
Apportionment Formula:		
District Sales	$ 295,687	.0038%
Total Sales	$7,853,393,381	
Net Taxable Income		$ 24,829.08
Tax at 5%		$ 1,241.45

[fol. 550]

BEFORE THE DISTRICT OF COLUMBIA TAX COURT

SUPPLEMENTAL STIPULATION—June 5, 1961

At the time of the signing of the Facts Stipulation, dated April 10, 1961, and admitted into evidence herein, counsel for the parties agreed to prepare a supplemental stipulation covering certain facts, and accordingly, the parties by their respective counsel stipulate and agree solely for purposes of these cases as follows: Either party may introduce additional evidence not in conflict herewith or with the Facts Stipulation or Numbers Stipulation, except with respect to the activities of the offices and personnel within and without the District and with respect to payroll and value of property of offices within the District and total payroll and total value of property, as to which Petitioner and Respondent elect to stand on the facts and descriptions set out in such Facts Stipulation and this Supplemental Stipulation.

1. *Zone Offices*

Prior to, but not after, July 15, 1956, Petitioner maintained in the District of Columbia Buick, Oldsmobile and Pontiac Zone Offices, the activities of which are described in the Facts Stipulation dated April 10, 1961. Prior to, but not after, July 1, 1948, Petitioner maintained in the District of Columbia a GMC Truck Zone Office, the activities of which are described in the Facts Stipulation dated April 10, 1961. At no time did Petitioner maintain in the District of [fol. 551] Columbia a Chevrolet Zone Office, the activities of which are described in the Facts Stipulation dated April 10, 1961. Petitioner did maintain within the District of Columbia throughout 1957 and 1958 a Chevrolet regional office in which the Chevrolet city manager was assigned space, all as described in the Facts Stipulation dated April 10, 1961.

2. *Bank Accounts*

(A) Petitioner maintained throughout 1957 and 1958 deposits in accounts with banks in the District of Columbia.

5. Petitioner's returns for 1957 and 1958 fairly and accurately reflect its gross income and deductions, and there is no issue between the parties except the determination of the portion of petitioner's net income subject to the District of Columbia Corporation Franchise Tax. Petitioner's "Total Sales Everywhere," the denominator of the apportionment formula, are $9,461,855,874 for the year 1957 and are $7,853,393,381 for the year 1958.

6. In determining "District Sales" (numerator of the apportionment formula) for its 1957 return, petitioner included only those sales of its United Motors Service Division in which the goods were shipped into the District of Columbia during the year 1957. In determining "District Sales" for its 1958 return, petitioner included only those sales of its United Motors Service Division in which the goods were shipped into the District of Columbia during the period January 1, 1958, to June 30, 1958.

[fol. 532] 7. Respondent mailed petitioner a notice of proposed deficiency for 1957, dated July 23, 1959, a copy of which is attached as Exhibit 1-A. The proposed deficiency, in the amount of $268,585.40, was computed as follows:

Net Income to Be Apportioned		$1,312,092,839.15
Apportionment Formula:		
District Sales	39,339,922	.4158%
Total Sales	$9,461,855,874	
Net Taxable Income		$ 5,455,682.00
Tax at 5%		272,784.10
Less Tax Paid		4,198.70
Tax Deficiency		$ 268,585.40

8. Respondent mailed petitioner a notice of proposed deficiency for 1958, dated November 2, 1959, a copy of which is attached as Exhibit 2-B. The proposed deficiency, in the amount of $167,468.44, was computed as follows:

Three petty cash fund accounts were maintained in such banks, one each for the Washington offices of the Patent Section, Government Sales Section and Public Relations Staff. Local personnel attached to the aforesaid Washington offices were and are authorized to draw upon these petty cash fund accounts.

(B) Other accounts in the name of General Motors Corporation were maintained with such banks in the District for depository purposes. One of these accounts is the regular depository for the Pontiac, Buick and Oldsmobile Zone Offices located outside the District of Columbia, the activities of which are described in the Facts Stipulation dated April 10, 1961. In addition, whenever any of Petitioner's divisions receives a check or draft in excess of a certain amount drawn upon these banks, such instruments are mailed directly to these banks for deposit. These accounts are controlled at Petitioner's Central Office in Detroit and [fol. 552] may be drawn upon only by authorized personnel located in Detroit, Michigan, or in New York City, New York. No local personnel in the District of Columbia were or are authorized to draw upon these depository accounts.

3. *Delinquent Parts Accounts*

In the event that a car or truck dealer becomes delinquent in paying for parts and accessories, it is a Zone Office responsibility to contact the dealer involved and to try to arrange for payment. Ordinarily, someone in the Zone Office will telephone the dealer and ask for payment, and if necessary, will visit the dealer and try to obtain payment. This matter would be handled for the Cadillac Motor Car Division by the Cadillac parts and service manager, whose activities are described in paragraph 8(I) of the Facts Stipulation dated April 10, 1961.

4. *Zone Manuals*

Attached hereto as Exhibit 1-A thirty-five pages extracted from the Oldsmobile "Zone Manual," which is a publication prepared by Oldsmobile Division at its headquarters, in

Net Income to Be Apportioned		$653,396,893.13
Apportionment Formula:		
District Sales	$ 40,619,172	.5172%
Total Sales	$7,853,393,381	
Net Taxable Income		$ 3,379,368.73
Tax at 5%		168,968.44
Less estimated Tax Paid, 4/13/59		1,500.00
Tax Deficiency		$ 167,468.44

9. In computing said deficiencies, respondent included in the numerator of the apportionment formula, as "District Sales," those sales which the Finance Officer determined to be the total sales by all of petitioner's divisions to District customers in which the goods were purchased by [fol. 533] customers in the District and shipped into the District to such customers during the taxable years involved. Petitioner and respondent agree that the Finance Officer (subject to the exceptions in Paragraph 11 of this stipulation) correctly determined the amount of sales as aforesaid, except that petitioner does not hereby concede or agree that the determination of the Finance Officer as to the deficiencies in tax assessed against petitioner was or is correct.

10. Attached hereto as Exhibit 3-C and incorporated into this stipulation by this reference is a schedule setting forth an analysis (by division, destination and customer) of petitioner's 1957 sales which respondent determined to be "District Sales" and included in the numerator of the apportionment formula applied for the tax year 1957. Attached hereto as Exhibit 4-D and incorporated into this Stipulation by this reference is a schedule setting forth an analysis (by division, destination and customer) of petitioner's 1958 sales which the respondent determined to be "District Sales" and included in the numerator of the apportionment formula applied for the tax year 1958.

11. As a result of an error in information furnished by petitioner, respondent included in "District Sales" the

Lansing, Michigan, and distributed to Zone Offices throughout the United States for their guidance. Actual procedures employed in any one Zone Office, including the one in Silver Spring, Maryland, might differ from those set forth in the manual. Buick, Pontiac and Chevrolet Divisions have Zone [fol. 553] Manuals which are not materially different from the Oldsmobile Zone Manual. The said Exhibit 1-A may be received in evidence to supplement but not to contradict the facts set forth in the Facts Stipulation dated April 10, 1961, and in this Supplemental Stipulation.

5. *"Agreed Standards of Sales Participation"*

(A) There is no agreement, understanding or commitment whatsoever existing between Petitioner and any of its dealers or distributors that the latter will buy any particular number of cars or trucks. The dealer or distributor places orders for and buys cars and trucks from Petitioner when the dealer or distributor so decides.

(B) The Oldsmobile Zone Manual refers on page O-III-7 (copy attached hereto as part of Exhibit 1-A) to an "agreed standard of sales participation." This is a method by which Petitioner and a dealer are able to evaluate the dealer's sales performance when such dealer is located in a multiple dealer area, such as the Washington metropolitan area. The Organization and Analysis Department of the Division tentatively computes the percentage of the total projected sales for the area which, on the basis of information available to it, it believes each dealer within the area may be expected to make. This is done on the basis of the dealer's sales history, population studies, projected market conditions and other judgment factors. Each dealer is then consulted with respect to this percentage, and a conclusion is reached that [fol. 554] some percentage of the total area sales will be regarded as his fair share. If he falls significantly below, he and Petitioner have an indication that his operation needs strengthening. A dealer's "standard of sales participation" (if any) as stated in Paragraph 14 of the Terms and Conditions of the Chevrolet and GMC Truck Selling Agreements (Exhibits 2-B and 3-C to the Facts Stipulation), is one of the factors used in evaluating a dealer's sales performance.

amounts of $2,154,218 for 1957 and $8,076,653 for 1958, which amounts represent (1) sales of goods billed to customers at offices within the District but shipped from stocks [fol. 534] of goods, outside the District to points outside the District and (2) fees for services rendered outside the District but billed to customers at offices within the District. The parties agree that these amounts, namely, $2,154,218 for 1957 and $8,076,653 for 1958, should be excluded from the numerator of the apportionment formula and that the tax deficiencies assessed and paid for 1957 and 1958 should be reduced.

12. Petitioner's net income to be apportioned for 1957 is $1,312,092,839 and its net income to be apportioned for 1958 is $653,366,893. In addition to such apportionable net income, petitioner realized income, properly allocable to the District as follows: $3,267 for 1957 and $8,727 for 1958 as dividends from dealership corporations in the District which were financed under the Motors Holding Division Plan, and $7,053 for 1957 and $6,691 for 1958 as interest from such dealership corporations. Petitioner also had gross income from rentals of automobiles and sublease of office space in the District, but had no net income from such rentals in 1957 and 1958.

13. Petitioner duly exhausted its administrative remedies with respect to such proposed deficiencies. After due and timely protests and hearings, respondent assessed the deficiencies as proposed, and as above set out. The statements of taxes due for 1957 and 1958 (copies of which are [fol. 535] attached as Exhibits 5-E and 6-F respectively) were dated February 24, 1960.

14. The 1957 tax in the amount of $268,585.40, plus interest of $34,916.10 was paid to respondent by petitioner under written protest (copy attached as Exhibit 7-G) on May 19, 1960. Additional interest thereon of $463.30 was paid to respondent by petitioner under written protest (copy attached as Exhibit 8-H) on May 20, 1960. A copy of the receipt for payment of the foregoing taxes, plus interest, for 1957 is attached as Exhibit 9-I. The 1958 tax in the amount of $167,468.44, plus interest thereon of $11,722.79

6. *Zone Office Participation in Government Sales*

(A) Throughout 1957 and 1958, as well as at present, Oldsmobile Division did not sell cars directly (through the Government Sales Section) to the federal government as did the other car and truck divisions. In the event that a government agency in the District of Columbia wished to buy an Oldsmobile automobile, the agency would contact the Washington office of the Government Sales Section which would refer the agency to a local Oldsmobile dealer with which the agency would negotiate its purchase.

(B) Invitations to bid, bid proposals, contracts, and sales of automobiles and trucks to the United States Government by Petitioner's car and truck divisions, other than Oldsmobile Division, were handled as described in Paragraph 11 of the Facts Stipulation dated April 10, 1961. The shipping procedure was as follows: In the event that a Pontiac or Buick automobile or a GMC truck was sold [fol. 555] to the federal government and was to be shipped into the District of Columbia, the Pontiac, Buick or GMC Truck Zone Office would select a dealership in the District of Columbia through which the car would be serviced and delivered to the federal government. Cadillacs sold to the federal government and destined for the District of Columbia were shipped to the Cadillac distributor in Washington, D.C., for service and delivery to the government agency involved. Cars and trucks sold to the federal government by the Chevrolet Motor Division and shipped into the District of Columbia were serviced at the factory or assembly plant and shipped directly to the government agency and were not serviced or delivered through Chevrolet dealers.

7. *General Motors Acceptance Corporation*

General Motors Acceptance Corporation is a wholly-owned subsidiary of Petitioner with an office in the District of Columbia which offers to finance wholesale and retail sales as outlined in the manual attached as Exhibit 2-B. This office served the District of Columbia and the surrounding area in Maryland and Virginia.

8. *Fleet Sales*

(A) Sales of fleets of automobiles and trucks are made directly by Petitioner's dealers or distributors to fleet users except that throughout 1957 and until May 1958 Petitioner made such sales directly to some political subdivisions such as states, municipalities, port authorities, [fol. 556] etc. Petitioner does not lease cars or trucks to fleet users.

(B) Throughout 1957 and 1958, Petitioner's Pontiac, Buick, Oldsmobile and Cadillac Divisions did not have employes comparable to the Chevrolet "fleet manager," whose activities are described in Paragraph 7(C) of the Facts Stipulation dated April 10, 1961. The Pontiac and the Cadillac Divisions did not make fleet user contacts in the District of Columbia during 1957 and 1958. The Buick and the Oldsmobile Divisions infrequently made such contacts through a "district manager" or the "assistant zone manager" attached to the Buick and Oldsmobile Zone Offices whose territory included the District of Columbia. Beginning May 1957 and through April 1958, a so-called "fleet representative," whose activities were comparable to those of the aforesaid Chevrolet "fleet manager," worked out of the GMC Truck Zone Office in Philadelphia, Pennsylvania, and called upon fleet users in the District of Columbia on the average of once every two months in order to promote the sale of GMC trucks. With the exceptions stated in Paragraph 8(A) above, all fleet sales are made by dealers or distributors directly to fleet users.

9. *Property Figures*

(A) The average value of Petitioner's real and tangible personal property owned and used in the District of Columbia during the calendar years 1957 and 1958 was $378,-[fol. 557] 476 for the calendar year 1957 and $347,025 for the calendar year 1958. The average value of all Petitioner's real and tangible personal property owned and used during the calendar years 1957 and 1958 was $6,146,-870,978 for the calendar year 1957 and $6,295,491,112 for the calendar year 1958. The average value of Petitioner's

real and tangible personal property rented and used in the District of Columbia during the calendar years 1957 and 1958 was $982,200 for the calendar year 1957 and $979,184 for the calendar year 1958. The average value of all Petitioner's real and tangible personal property rented and used during the calendar years 1957 and 1958 was $100,289,392 for the calendar year 1957 and $108,182,464 for the calendar year 1958.

(B) The property values set forth in Paragraph 9(A) above are computed as follows: Property owned by Petitioner is valued at its original cost, except that some inventories are valued at the lower of cost or market. Property rented by Petitioner is valued at eight times the annual rentals paid. No deduction from the rentals paid by Petitioner is made for any offset received by Petitioner from subrentals, which are insignificant in amount. The average value of property owned for each calendar year is determined by averaging the values at the beginning and ending of each such calendar year.

(C) The average net book value of Petitioner's real and [fol. 558] tangible personal property owned and used in the District of Columbia during the calendar years 1957 and 1958 was $317,613 for the calendar year 1957 and $278,035 for the calendar year 1958. The average net book value of all Petitioner's real and tangible personal property owned and used during the calendar years 1957 and 1958 was $3,947,603,363 for the calendar year 1957 and $3,800,307,301 for the calendar year 1958. The net book value of said property, other than inventories, is original cost less accumulated book depreciation and obsolescence, and the net book value of inventories is the lower of cost or market. The average net book value for each calendar year of said property is determined by averaging the net book values at the beginning and ending of each such calendar year.

10. *Payroll Figures*

(A) The total amount of compensation paid in the District of Columbia by Petitioner was $1,203,081 for the

calendar year 1957 and $1,158,093 for the calendar year 1958. These amounts were used and reported by Petitioner to the District of Columbia for Unemployment Compensation Tax purposes for the calendar years 1957 and 1958 and are the totals for each such calendar year of the amounts set forth on Line 7 of Petitioner's Employer's Quarterly Contribution Reports for the District of Columbia (Forms DUCB-30) for each such calendar year, as corrected for the quarters ending June 30, 1957, and Sep-
[fol. 559] tember 30, 1957. Copies of said Quarterly Contribution Reports (including Statements to Correct Information for the quarters of June 30, 1957, and September 30, 1957) filed by Petitioner with the District of Columbia Unemployment Compensation Board are attached hereto and incorporated herein as Exhibit 3-C. In addition to the foregoing, compensation of approximately $421,906 in 1957 and $439,433 in 1958 was paid by Petitioner to employes who made regular visits to the District of Columbia with an average frequency of approximately one or more times a month. Based on the time spent by such persons in the District, $65,099 of such compensation in 1957 and $75,-694 of such compensation in 1958 was paid on account of services rendered in the District.

(B) The total compensation paid everywhere by Petitioner was $2,662,072,037 for the calendar year 1957 and $2,354,049,741 for the calendar year 1958. These amounts represent the sum of Items 2 and 5 on Schedule B of the Federal Unemployment Tax Returns (Form 940) filed by Petitioner for the calendar years 1957 and 1958 (namely, $2,661,204,176 for the calendar year 1957 and $2,352,792,-432 for the calendar year 1958), plus the total wages paid by Petitioner to employes who are United States citizens working outside the continental limits of the United States and whose wages are not subject to Federal Unemployment Tax but whose wages are subject to Federal Insurance Contributions Act Tax (namely wages of $867,861 for
[fol. 560] the calendar year 1957 and wages of $1,257,-309 for the calendar year 1958). Copies of Schedule B of Petitioner's Federal Unemployment Tax Returns for the calendar years 1957 and 1958 are attached hereto and incorporated herein as Exhibit 4-D.

11. It is further understood and agreed that the dollar amounts set forth in Paragraphs 9 and 10 of this Supplemental Stipulation are included herein at Petitioner's request in order that strict and formal proof of said dollar amounts shall not be required, and Respondent has agreed to their inclusion solely for the purpose of reducing the time required for the trial of these cases. Respondent, by so agreeing, does not, however, stipulate or concede that these amounts or the basis upon which they are predicated are pertinent, material or relevant, or that they may be admitted into evidence, and Respondent specifically reserves the right to object to the admission of said Paragraphs 9 and 10.

12. *Supplements to Exhibits 3-C and 4-D of the Numbers Stipulation*

The numbers Stipulation has been admitted into evidence as Petitioner's Trial Exhibit 3. Attached hereto as Exhibits 5-E and 6-F and incorporated into this Stipulation by this reference are Supplements respectively to Exhibit 3-C of the Numbers Stipulation and to Exhibit 4-D of the Numbers Stipulation. These Supplements further segregate and explain the sales figures set forth under [fol. 561] the heading "Sales of Goods Shipped from Stocks Outside the District to Points Within the District" on said Exhibits 3-C and 4-D of the Numbers Stipulation.

13. *"Wholesale Parts Compensation Plan"*

The Oldsmobile Zone Manual refers at page N-15 (copy attached hereto as part of Exhibit 1-A) to a "wholesale parts compensation plan." This plan provides for the payment of compensation to a motor vehicle dealer or distributor when he performs a wholesaling function in the distribution of motor vehicle parts covered by the plan. Approximately 90% of the parts available for sale to motor vehicle dealers and distributors were covered by the plan throughout 1957 and 1958. In the event that a dealer or distributor sells parts covered by the plan to a qualified wholesale customer (such as an independent garage or repair shop), he is entitled to an overriding dis-

count on the price at which the parts were sold to him by Petitioner. This overriding discount, or rebate, is known as "wholesale parts compensation." Throughout the calendar years 1957 and 1958, the overriding discount varied from 10% to 40%, depending upon the part involved, of the price paid by the dealer or distributor to Petitioner.

Throughout 1957 and 1958, Cadillac distributors received an additional discount of 12½% from dealer net prices on Cadillac parts (exclusive of accessories and engines) which they resold to the dealers appointed by them. [fol. 562] Such distributors received a discount on Cadillac automobiles resold by them to their dealers which, except in the case of one model accounting for less than 5% of sales, was 4% more than the discount allowed to "direct" dealers appointed by Cadillac and purchasing directly from Cadillac.

Similarly, a Buick distributor received an additional discount of 12½% from dealer net price on Buick parts (exclusive of accessories and engines) which it resold to the dealers appointed by it, and an overriding flat discount of $35 or $50, depending on model, on each Buick automobile resold by it to its dealers. The territory in which such distributor operates does not include the District.

Dated: June 5, 1961.

[fol. 563]

BEFORE THE DISTRICT OF COLUMBIA TAX COURT

PETITIONER'S EXHIBIT No. 6-a

EXTRACTS FROM GENERAL MOTORS CORPORATION MANUAL

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PARTS

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PARTS AND ACCESSORIES N-1

ACCESSORIES

Purpose

Accessories for Oldsmobile cars are components that are developed to offer added comfort, convenience, safety, appearance and pleasure for car owners. Before being made available, they are thoroughly tested to meet exacting quality and performance specifications by Oldsmobile's Engineering Department.

The selling of accessories offer a fair gross profit to dealerships and to Oldsmobile. They contribute to new car sales by improving the dealership trading position and by offering many factors that appeal to new car prospects.

Zone Management Responsibility

Zone Management is responsible for the selling of accessories to some dealerships. This includes the administrating of responsibilities for . . .

1. Conducting and logically pursuing to a conclusion, home office developed sales programs.
2. Creating and developing accessories sales campaigns at the zone level.
3. Determining that dealerships carry an adequate stock of Oldsmobile accessories for resale to car owners.

4. Determining that dealerships equip demonstrators, display and promote for sale Oldsmobile engineering approved accessories.

5. Reviewing zone accessories sales accomplishments with zone sales personnel.

6. Determining that all company cars are well equipped with accessories for demonstrating purposes and to encourage dealers to do likewise.

Availability and Pricing of Accessories

"Accessory Release and Change Notice", which is issued at the beginning of a new model, contains the only authentic listing of all available accessories by part number, description, dealer net price, suggested list price and warehouse stocking classification. It itemizes all current model, universal and available past model accessories and informs of all discontinuations. It is released monthly whenever changes occur and is numbered in sequence starting with a new model car. A master set of these notices should be maintained for an authentic guide to available accessories and their prices. (See Desk Manual—Operation No. 800).

Prices of accessories are also listed in numerical part number sequence in the "Dealer's Parts Price Schedule".

Revised October 15, 1958

N-2

[fol. 565] Distribution of Accessories

1. Accessories ordered on the "Wholesale Car Order" (See Desk Manual—Operation No. 506) are production installed or shipped with a new car from the Factory or Regional Assembly Plants.

2. Accessories ordered for dealership stock are shipped from either a General Motors Parts Division (G.M.P.D.) Warehouse or the Lansing Factory Warehouse. Source of shipment can be determined from the "Accessories Release & Change Notices" warehouse symbol, "F" is indicative of Factory, "Z" is Zone or "M" is Master G.M.P.D. Warehouse. (See Section "N" In-

dex for G.M.P.D. Warehouse Classification and Location).

Ordering of Accessories

Accessories may be ordered from dealership source by telephone, telegram or in writing. To facilitate procedure, printed forms are made available . . .

1. Wholesale Car Dealers, Form 511—Olds: Accessories ordered on this form by dealers are installed on the car (or shipped with the car) at the Assembly Plant or Factory. In the event accessories are shipped with the car and not installed, dealers are advised of this policy. Provision is made on this order whereby dealers can order a group of accessories by designating the numerical group desired or they can order individual accessories by checking the alphabetical symbols. The new car buyer is inclined to feel that factory installed accessories are a component part of the car and that they represent but a nominal amount of the deferred payments. Therefore, dealers should be encouraged to order accessories on this order form.
2. Monthly Parts Order contains a printed section for ordering accessories on a systematic and inventory control basis. Its regular use should be encouraged in order to provide availability and investment turnover. (See Desk Manual—Operation No. 812).
3. Special Sales Circular-Order Blanks are released to announce new merchandise and to campaign selected items. (See Desk Manual—Operation No. 802).
4. Accessories Order Pad itemizes all current accessories. It is fabricated for use of zone personnel to solicit orders from dealerships. (See Desk Manual—Operation No. 801).
5. Supplementary Stock Order (PC-66) is designed for ordering items to supplement regular stock or for emergency orders. (See Desk Manual—Operation No. 815).
6. Company Car Packaged Accessories Order (PA 56) is designed for use of Zone Car Distributor for ordering accessories from the factory for installation on

zone company cars. (See Desk Manual—Operation No. 831).

Revised October 15, 1958

N-3

[566] Controlling Accessories Inventory

Maintaining a balanced stock of accessories or a 60 days inventory based on the dealership rate or anticipated rate of sale is the best assurance of sales profit, turnover and a minimum of obsolescence.

The group sequence Monthly Parts Order which lists all accessories, has provisions for maintaining an inventory control. As a model year draws to an end, consideration should be given to reducing the inventory in relation to car sales.

The Factory Parts and Accessories Department controls the accessories inventories in G.M.P.D. Warehouses semi-monthly, based on the sales history of each item. WHENEVER A ZONE CAMPAIGNS AN ACCESSORY, THIS DEPARTMENT SHOULD BE INFORMED OF ANTICIPATED SALES IN ORDER THAT WAREHOUSE STOCK CAN BE INCREASED.

Transportation

Prepaid transportation from shipping point to the city where Dealer's place of business is located will be allowed on any individual order for L, LL, C. CX, P and PX parts (exclusive of major assemblies priced f.o.b. Lansing, Michigan) or any individual order for L, LX, C, CX, P and PX accessories, provided the order equals or exceeds $50.00 at Dealer Net Prices, except that; prepaid transportation will be allowed only to the Port of Departure from the United States mainland on such orders being shipped to the State of Alaska.

Normally, shipments are made to dealerships the cheapest way. Requests for special shipping will be honored upon instructions from the dealership.

Transportation charges on Returned Exchange items will be allowed dealer on one return shipment per month of exchange items as specified by Oldsmobile from time to time.

Invoicing

Dealer's purchases will be invoiced at Dealer Net Prices established from time to time as specified in the Oldsmobile Dealer's Parts Price Schedule and supplements thereto, or Release and Change Notices in effect at the time of shipment, f.o.b. shipping point.

Terms of Payment

The parts and accessories account of Dealer is due and payable, as per statement rendered, on or before the tenth (10th) of the month following the date of billing. If parts and accessories account is not paid as specified, Oldsmobile reserves the right to make further shipments C.O.D. Shipments so made shall not be released from C.O.D., but must be taken up and accepted by Dealer on a C.O.D. basis.

Revised October 15, 1958

[fol. 567] Receiving of Accessories N-4

Care must be exercised by dealers in the receiving of accessories. The shipment should be checked to determine that all packages, boxes, crates, etc., making up the shipment as designated on the shipping receipt or Bill of Lading are received. The shipment should also be inspected for damage at the time it is received, and if it is noted that damages have occurred, these should be brought to the attention of the carrier and a note made on the delivery receipt. If the quantities do not agree with the quantities shown on the shipper, this should be promptly brought to the attention of the shipping warehouse. Forms are provided to dealerships for filing claims with the warehouse. Complete instructions for filing these claims are printed thereon. Accessories received with cars from Assembly Plants or from the factory should be checked to determine that the accessories agree with the items listed on the car billing and with the Wholesale Car Order. In the event there are shortages, the dealer should bring this to the attention of the Zone Car Distributor, advising the items that were not included with the car and the invoice number on which the car was billed. Accessories ordered with cars,

if not installed by the Assembly Plant or Factory, will not be back ordered. Dealer must write a separate order to obtain these accessories. All claims for shortages of accessories for which the dealer has been billed must be reported promptly.

Return of Accessories

Accessories ordered or shipped in error may be returned within 30 days after being received by the dealer.

Dealers may make application covering new and unused surplus accessories that have been in stock more than 30 days. Such applications must be approved by the Zone Manager and forwarded to the Parts & Accessories Department, Lansing.

If dealers purchase accessories direct from Oldsmobile for use in connection with specific motor vehicles for which orders have been placed with and accepted by Oldsmobile and such motor vehicles are not shipped to dealer prior to the introduction of new motor vehicle models, thereby cancelling such orders, then to the extent such accessories are not usable on the new models and are in excess of dealer's requirements, they may be returned for credit.

Terminated dealers may return only those accessories which were purchased from Oldsmobile within 12 months prior to the termination. Accessories accepted for return must be new and unused.

See Operation No. 818 for Return Material Forms.

There is no obsolescence protection plan covering the return of accessories.

Company Car Accessories

Successful selling depends in a major manner on displaying and demonstrating. Therefore, zone company cars should be completely equipped with accessories. They not only familiarize zone personnel with the merchandise they have to sell, but also serve for demonstrating purposes and encourage dealers to equip their demonstrators with accessories. The zone car distributor should fill in and send this PA-56 form at the time an order is entered for a zone car. (See Page N-2 Item 6).

[fol. 568] Selling Accessories

There are two practical aspects in the selling of accessories to dealers that are the prime requisite of zone personnel.

1. Selling the products and soliciting orders for same.
2. Suggesting ideas and plans to dealers and their personnel that will contribute to the retail selling of accessories.

SELLING

Know the products by reading and studying all accessories bulletins and printed matter.

Learn their application, use and advantages.

Demonstrate and display their use on your car.

Extol with conviction, their excellency at every opportunity.

Observe for competitors products to determine why ours is not being offered for sale.

Discuss the advantages of Oldsmobile engineering approved accessories for Oldsmobile cars.

Encourage maintaining a balanced stock of all items to increase sales and reduce obsolescence.

Ask for an order. (See Page N-2)

SALES PROMOTION

After the sale of accessories to a dealership, effort should be expended to help them sell the merchandise to car owners.

Thoroughly explain to key dealership personnel, factory released promotional programs and make every effort to encourage their use.

Observe for successful selling plans and ideas in all dealerships and suggest their use by other dealers.

Encourage dealers to attractively display merchandise and neatly maintain displays so that they will invite inquiries.

Suggest seasonal displays and selling ideas that will increase merchandise and labor sales profits.

Revised October 15, 1958

[fol. 569] N-6

Encourage dealers to equip all demonstrators and display cars with all accessories.

Discuss accessories at dealership sales meetings and explain that each accessory is designed to offer added safety, comfort, convenience, pleasure and/or ornamentation.

Discuss with dealer the incentives or commission that he offers to car and service salesmen for selling accessories in order to stimulate sales.

Explain the use of "Accessories Bonus Card" (Form PA-46) for service and parts personnel (See Desk Manual—Operation No. 806).

Periodically check dealership accessories stock and offer ideas that will sell items not being sold or for increasing sales on other merchandise on hand.

Accessory Displays

One of the basic principles of merchandising is to—Display the commodities which are being offered for sale. The selling of accessories is a profitable phase of a dealership's business and more accessories can be sold if a merchandising atmosphere is created. Interest in merchandise is primarily developed through sight and the ability to handle the merchandise.

New car prospects are more receptive to buying accessories when signing the new car order. Therefore a display of accessories should be made in the closing office or adjacent to the salesmen's desks. (See Desk Manual—Operation No. 803).

An attractive display of accessories should be made in the new car showroom and in the customer reception area

of the Service Department. These displays will attract attention, create interest, and invite inquiries. They will contribute toward selling merchandise as car owners are encouraged to buy what they see displayed.

Dealers should be encouraged when setting up new Parts Departments or when re-designing Parts Departments to provide for permanent accessory displays.

Sales Reports

Zone management is informed each month of their zone accessories sales accomplishment in the "Digest of Parts and Accessories Activities" (PA-128). This report states —(A) The month and year-to-date net dollar sales. (B) The month and Year-to-date zone and national average of sales per car delivered. (C) The month and year-to-date numerical group sales. (D) The zone and national average *model* year-to-date percent (some items unit) sales of each accessory.

Revised October 15, 1958

N-6A

[fol. 570] Warranty and Policy

The warranty on accessories is covered in the "Dealer Selling Agreement" and in the Service Section of the "Master Zone Office Manual". Detailed information is released in "Dealer Technical Information Bulletin" released prior to each model.

Establishing New Dealers

Since the sales of accessories contribute to the gross profits of a dealership in a major manner, it is imperative that they be thoroughly and methodically discussed with key dealership personnel.

Explain the complete line of accessories to the dealer, sales, parts and service managers.

Explain to the dealer and sales manager the ordering of accessories on the Wholesale Car Order and to the parts and service managers, ordering and distribution for stock (See Page N-2).

Obtain a balanced initial stock order of all accessories and explain how to maintain a balanced stock thru inventory control.

Determine that adequate facilities are available for stocking merchandise.

Explain pricing and availability to parts managers. (See Page N-1).

Explain transportation, invoicing, payment terms, receiving and returning policies and procedures (See Pages N-3 and N-4).

Explain warranty and policy procedure (Page N-6A).

Encourage dealer to equip demonstrators and display cars with accessories and to have merchandise displays in the showroom, parts department and customer reception areas.

Suggest ideas and plans that will contribute to the retail selling of accessories.

Make notes of and follow-up on succeeding contacts, all recommendations, ideas and plans that were discussed.

Revised October 15, 1958

N-7

[fol. 571] Purpose

Parts for Oldsmobiles are components for replacing worn, imperfected or damaged parts of a car. They are produced and inspected with parts that are assembled into a new car or made from the same tools after current production.

Zone Management Responsibility

Zone Management is responsible for the selling of parts and to administrate . . .

1. The delegating of assignments to determine that a dealer is complying with the "Dealer Selling Agreement" by carrying in stock at all times, an adequate number and assortment of parts to render proper service to owners of Oldsmobile motor vehicles and

chassis . . . that dealers do not sell, offer for sale or use in the repair of Oldsmobile motor vehicles and chassis as new Oldsmobile repair parts, any part or parts which are not in fact new parts manufactured by or for Oldsmobile, designed for use on Oldsmobile vehicles and distributed by Oldsmobile or any division or subsidiary of General Motors Corporation.

2. The conducting and logically pursuing to a conclusion, home office developed programs such as new model initial stock orders, regular stock orders and special programs.
3. The creating and developing of parts programs at the zone level.
4. The training of zone personnel so that they will have knowledge of all parts policies and procedures as defined in the Zone Office Manual and other special bulletins.
5. Reviewing zone parts sales and stock order pad accomplishments with zone sales personnel.
6. The maintaining of Master Parts Books and Dealer's Parts Price Schedule with current information.
7. Investigate any parts distribution complaints with G.M.P.D. Warehouses and endeavor to coordinate handling procedures between dealers and warehouses.

Identification of Parts

Once each model year, Chassis and Body Parts Books are revised to incorporate new model parts and to list previous model parts for which there is a service demand. There are two basic means of identifying parts—(1) The Alphabetical Index, when the name of a part is known. (2) The illustrative pages for visual identification. Both means refer to a "group number" which classifies a part for final part number identification. Information for maintaining parts books up to date is supplied on "Parts Release & Change Notice" (See Desk Manual—Operation No.

809) and Parts Book Revision Pages (See Desk Manual—Operation No. 811).

Revised December 2, 1958

[fol. 572] Availability And Pricing Of Parts N-8

Each model year a new and complete "Dealer's Parts Price Schedule" is sent to every dealership. It lists *every available* item and its group and part number in part number sequence. It also shows the warehouse code (or where the item is stocked) and the dealer cost and suggested selling prices.

New part prices and changes in prices on current parts are mailed monthly to dealers for maintaining the Parts Price Schedule up to date on a "Price Change Notice" (See Desk Manual—Operation No. 809).

Each month new or revised replacement pages of the "Dealer's Parts Price Schedule" on which changes occur, are sent to dealerships who subscribe to this nominally charged service. This service saves writing in changes from the Price Change Notices. (See Desk Manual—Operation No. 810).

Distribution Of Parts

Oldsmobile parts are distributed to Oldsmobile and other authorized General Motors car dealers through the General Motors Parts Division and Factory Parts Warehouses. Every dealership is assigned a particular zone and/or master warehouse to serve them.

Parts are stocked in G.M.P.D. Warehouses according to their sales classification—Fast moving parts ("Z") are stocked in Zone and Master G.M.P.D. Warehouses and at the factory. Slower moving parts ("M") are stocked in Master G.M.P.D. Warehouses and at the factory. Very slow ("F") items are stocked only at the factory. These classifications are shown with each part number in the "Dealer's Parts Price Schedule".

Parts interchangeable between Chevrolet, Oldsmobile and Pontiac are coded CX, LX and PX respectively. The stocking of these parts is controlled by each respective car division. CX and PX factory classified items are not

stocked in Lansing and are are shipped direct from the Chevrolet or Pontiac factory warehouses. Every G.M.P.D. Warehouse has a car code record for each part.

The Oldsmobile parts (L and LX) stocked in G.M.P.D. Warehouses are the property of Oldsmobile and it is the function of G.M.P.D. to stock and disperse this merchandise from orders received from dealers. The quantity of each item stocked is controlled, based on sales demand from each warehouse, by a central inventory control department of G.M.P.D. The location and type of G.M.P.D. Warehouses is shown on Operation No. 808 of the Desk Manual.

Inventory Investment

In accordance with the "Dealer Selling Agreement", dealer will carry in stock at all times an adequate number and assortment of parts and accessories to render proper service to Oldsmobile owners. Dealer will not sell, offer for sale, or use in the repair of Oldsmobile motor vehicles and chassis as new Oldsmobile repair parts, any part or parts which are not in fact new Oldsmobile repair parts, defined as being parts and accessories manufactured by or for Oldsmobile, designed for use on Oldsmobile motor vehicles or chassis, and distributed by Oldsmobile or any division or subsidiary of General Motors Corporation.

Revised December 2, 1958

N-9

[fol. 573] Experience has shown that an investment in parts inventory should be equivalent to an average months cost of sales (dealer net price) times four. This will give three turn-overs per year. Since 80% of Oldsmobile's dollar sales are represented with items listed in the "Zone Monthly Stock Order", a dealership investment should be approximately in this ratio for these fast moving items. The balance of the investment should be in slower moving essential items.

To determine the amount to be invested in a parts inventory for a new dealership and the items to stock, refer to Operation No. 816 in the Desk Manual.

Ordering Of Parts

Parts may be ordered by a dealership from their serving Zone or Master G.M.P.D. Warehouse or the factory by telephone, telegram or in writing. To facilitate ordering procedure, printed forms are made available . . .

1. Monthly Parts Order (See Desk Manual—Operation Nos. 812 & 813). These printed stock order forms are available in two types . . .

   (a) "Parts Control Record and Stock Order" lists the parts in group number sequence for convenience in checking the bins for stock on hand. Order incorporates an inventory control system for maintaining a balanced stock. (See Desk Manual—Operation No. 812).

   (b) "Numerical Sequence Parts Order" lists the items in part number sequence to facilitate writing a stock order in dealerships where a card or perpetual inventory control system is employed. (See Desk Manual—Operation No. 813).

2. "Stock Exhausted Order" is designed to assist dealerships to obtain fast shipment of items on which stock is exhausted and merchandise will be needed before the monthly parts order is received. This green colored order blank has form number PC-66-B. (See Desk Manual—Operation No. 821).

3. "Supplementary Stock Order" is designed for replenishing inventories on which sales have increased and for ordering items not normally stocked. This white order blank has form number PC-66. (See Desk Manual—Operation No. 815).

4. "Car and Truck Inoperative Order", form PC-66-A, is printed on pink paper to denote emergency. It is to be used only for parts to repair an inoperative car. Separate forms are required for each vehicle that is inoperative. (See Desk Manual—Operation No. 817).

NOTE—Order forms PC-66-B, PC-66 and PC-66-A are to be obtained by a dealership from its serving G.M.P.D. Warehouse.

5. Special order forms are released to campaign selected merchandise such as new model non-interchangeable parts, Physical Inventory Records, etcetera, by the factory and by Zone Offices for Safety Check items, etcetera.

Revised December 2, 1958

N-10

[fol. 574] Controlling Parts Inventory

A system for maintaining an adequate and balanced stock that will give efficient turnover through replacing sold merchandise systematically, is essential for promptly serving customers and earning a fair gross profit. It means doing business on a factual basis instead of guessing!

The Monthly Parts Order (Forms PA-82 and PA-83) incorporates an inventory control system. Instructions for its use are printed in these group sequence order pads.

Dealerships employing a perpetual inventory control, may obtain pre-printed record cards (5″ X 8″) listing all Zone and Master Order Pad items from the Reynolds and Reynolds Company, Celina, Ohio. These dealerships should use the "Numerical Sequence Parts Orders" (Forms PA-200 and PA-202).

Location Of Parts Department

The correct location of a parts department within the dealership contributes to greater sales and operating efficiency. It should be accessible to customers, mechanics, the receiving of merchandise and adequate parking facilities for wholesale customers.

Some of the physical aspects of parts facilities that should be considered are—

Character of material (bin or bulk items)—

Certain items near counter, desks and file cabinets—

Parts in group sequence—Counter accessibility—

Width of aisles—Sales Area—Cashier facilities—

Receiving Area—Lighting—Display Area—Telephone locations—

Inventory Control facilities—Handling A.F.A. Material—

Storage of oil, grease, tires, anti-freeze and shop supplies—

Keeping department locked

It is a good plan to make a scale drawing and position everything on paper. Allowance should be made for expansion.

Location Of Stock In Parts Department

The efficient utilization of space, storing in its proper location and identification of merchandise, is essential in order to avoid errors and for quick disbursing.

Small parts should be stored in bins, gasket (Usually) on boards and bulky parts on shelves, hangers and racks in group sequence. Accessories and shop supplies should be stored on shelves in a convenient location. Extra or empty bin space should be allowed at regular intervals to provide for expansion and new part numbers.

Oldsmobile makes available each model year, a set of labels covering items normally stocked by dealers. It also provides a change service for supplying labels for new, and superseded items. These labels show the group and part number, year and model information. They are printed on colored cardboard to indicate sales popularity. White—very fast order pad items; Green—fast moving order pad parts; Yellow—medium fast Master order pad items; Red—slow moving parts; Blue—superseded parts. (See Desk Manual—Operation No. 819).

Revised December 2, 1958

N-11

[fol. 575] Parts Department Equipment And Operating Supplies

Bins for small parts, shelving, storage racks and related equipment are available from reputable sources in most metropolitan cities. Although Oldsmobile makes no specific recommendations, it is recommended that uniformity be

maintained with standard automotive equipment in order that shelving can be economically changed when necessary or additions made for expansion.

Body and Chassis Parts Books and Dealer Price Schedules should be ordered from Oldsmobile, Parts and Accessories Department, Lansing.

Binders for Body and Chassis Parts Books and Price Schedules should be ordered from Lansing Lithographers, 934 Clark Street, Lansing.

Perpetual Inventory Control Cards and equipment can be obtained from Reynolds & Reynolds Company, Murlin and Pine Streets, Celina, Ohio.

Monthly Parts Orders should be ordered from Parts and Accessories Department, Lansing. Specify group or numerical sequence type.

Supplementary Stock Order, Stock Exhausted Order, Car Inoperative Order and *Return Material* forms should be ordered from dealerships' serving G.M.P.D. Warehouse.

Physical Inventory Record should be ordered from Lansing Lithographers, 934 Clark Street, Lansing.

Bin Labels should be ordered from Parts and Accessories Department, Lansing.

Transportation

Normally, shipments are made to dealerships the cheapest way. Requests for special shipping will be honored upon instructions from the dealership.

Prepaid transportation from shipping point to the city where Dealer's place of business is located will be allowed on any individual order for L, LX, C, CX, P and PX parts (Exclusive of major assemblies priced F.O.B. Lansing, Michigan) or any individual order for L, LX, C, CX, P and PX accessories, provided the order equals or exceeds $50.00 at Dealer Net Prices, except that; prepaid transportation will be allowed only to the Port of Departure from the United States mainland on such orders being shipped to the State of Alaska.

Transportation charges on Returned Exchange items will be allowed dealer on one return shipment per month of exchange items as specified by Oldsmobile from time to time.

Invoicing

Dealer's purchases will be invoiced at Dealer Net Prices established from time to time as specified in the Oldsmobile Dealer's Parts Price Schedule and supplements thereto, or Release and Change Notices in effect at the time of shipment, F.O.B. shipping point.

Revised December 2, 1958

N-12

[fol. 576] Terms Of Payment

The parts and accessories account of Dealer is due and payable, as per statement rendered, on or before the tenth (10th) of the month following the date of billing. If parts and accessories account is not paid as specified, Oldsmobile reserves the right to make further shipments C.O.D. Shipments so made shall not be released from C.O.D., but must be taken up and accepted by Dealer on a C.O.D. basis. (See Parts Accounts section of this manual).

Receiving Parts

Upon receiving a shipment, the carrier's way bill or document should be checked for the exact number of cartons, boxes, bundles or loose items specified thereon. Each package should be checked for the dealership name, visible damage and the carrier's document against the bill of lading mailed to the dealership by the shipper. If discrepancies exist, note shortage or damage on carrier's and dealer's copies and have delivery man sign both copies before his copy is signed acknowledging receipt of shipment.

If discrepancies exist on PREPAID shipments, advise the shipper with a "Dealer Transportation Claim" (PC-65) (See Desk Manual—Operation No. 1302). If discrepancies exist on COLLECT shipments, file claim immediately and directly with the transportation company. If discrepancies are CONCEALED, report upon discovery to the carrier, the loss or damage.

After receiving a shipment from the carrier, each item should be checked against the shipper's packing slip. These slips are enclosed in the container marked with colored crayon. Any discrepancies should be immediately reported to the shipper.

Return Of Parts

Oldsmobile accepts for return certain parts *that have been purchased from Oldsmobile.* Return policies and procedures are as follows . . .

Unsalable Parts Return Plan—During the months of August, September or October of each year, dealerships may return to Oldsmobile one shipment of new, unused and undamaged Oldsmobile parts for a maximum credit value not to exceed four percent of dealer's net purchases of such parts during the previous fiscal year beginning July 1 and ending June 30. For complete details and conditions of this plan, refer to 6-E of the current "Dealer Price List" form 456-Olds.

In order to simplify and expedite the procedure of returning parts under this plan, "Return Material Classification Listing Books" are made available to use in lieu of the PC-659 Return Material forms.

Ninety (90) Day Returns—Dealer may return any new Oldsmobile parts purchased direct from Oldsmobile, which are in good condition and unused, for credit within ninety (90) days (accessories—30 days) after receipt by dealer. Such parts, accessories and service supplies shall be packaged or crated and shipped to the destination specified by Oldsmobile, transportation charges prepaid. Return of parts are to be handled as instructed on the back side of Page 3 of Form PC-659 (See Desk Manual—Operation No. 818). Dealer, however, will not be entitled to return materials which are acquired or fabricated specially by Oldsmobile upon dealer's order for a particular service order or car, including unlisted parts or assemblies and any cut or fabricated upholstery or trim items.

Revised December 2, 1958

[fol. 577] *Inactive Parts Return*—In the event dealer develops an inactive stock of Oldsmobile parts, or for any other reason desires to liquidate a portion of its parts stock, Dealer may submit to Oldsmobile a list of those parts purchased direct from Oldsmobile, in good condition and unused, which Dealer desires to return for credit. Oldsmobile shall promptly review said list and notify Dealer as to which parts will be accepted, the prices therefor and the proper shipping instructions. Thereupon Dealer may package or crate and ship such parts, transportation charges prepaid, in accordance with Oldsmobile's instructions.

Zone Office will review application to make certain all required heading information is shown, and forward all three copies to General Motors Parts Division, G-6060 W. Bristol Road, Manager Parts Distribution, Attention: Supervisor History Department, Flint, Michigan. Flint will enter disposition code for each item listed and forward all three copies to dealer's normal shipping warehouse. Upon receipt, dealer's normal shipping warehouse will retain #1 copies of application and forward #2 and #3 copies to dealer together with a form letter of transmittal.

Defective Parts Return—Dealer may return for credit, defective Oldsmobile parts and accessories purchased from Oldsmobile. Such items are to be packaged or crated and shipped transportation charges prepaid. Dealer will be credited at current dealer net price, plus ten percent and for prepaid transportation charges.

Exchange Parts Return—Transportation charges will be allowed Dealer on one return shipment per month of exchange items as specified by Oldsmobile, from time to time.

Terminated Dealers' Parts and Accessories Return—In the event of termination of the Dealer's Selling Agreement or in the event Oldsmobile does not offer Dealer a new Selling Agreement upon the expiration of the current Agreement, Oldsmobile will purchase from Dealer and Dealer will sell to Oldsmobile—

All unused and undamaged Oldsmobile repair parts listed in the current Oldsmobile Dealer's Parts Price Schedule and purchased direct from Oldsmobile, or purchased from

an outgoing Oldsmobile dealer as a part of Dealer's initial Oldsmobile parts inventory, and on hand in Dealer's place of business or in Dealer's possession at the then current dealer net prices plus five percent (5%) thereof for packing costs and plus reimbursement for transportation charges to destination specified by Oldsmobile.—

All unused and undamaged Oldsmobile accessories and service supplies purchased direct from Oldsmobile during the twelve (12) month period immediately preceding the effective date of such termination and on hand in Dealer's place of business or in Dealer's possession at the then current dealer net prices plus five percent (5%) thereof for packing costs and plus reimbursement for transportation charges to destination specified by Oldsmobile.

Dealer shall, within thirty (30) days following the date of termination, furnish Oldsmobile with a list of the motor vehicles, chassis, parts, accessories, signs and tools aforesaid.

Revised December 2, 1958
N-14

[fol. 578] Terminated dealer is to list parts only and accessories only on separate PC-659 Application forms (in triplicate), and forward all three copies of each form used to the Zone Office, attention Zone Manager, who will take the following action:

(a) Check each page of both parts and accessories applications to determine if properly prepared, including the following minimum information: Date, Warehouse Location, Dealership Name and Address, Part Number, Name of Part (or Accessory), Quantity to return and Reason for Return.

(b) *Parts Applications—if found in order, Zone manager should sign on "Zone Office" line (in triplicate) on first set of application pages only and forward all sets with a letter of transmittal to the Dealer's normal shipping warehouse.*

(c) ACCESSORIES APPLICATIONS—If found in order with respect to (a) above, Zone Manager will determine if (1) the total value of items is substan-

tially less than the dealer's total accessories purchases from Oldsmobile during the twelve (12) months immediately prior to termination and (2) the quantity of each item listed appears to be less than the dealer's total purchases of such items from Oldsmobile during the preceding twelve (12) months. Then the APPLICATIONS WILL BE SIGNED and forwarded as outlined in (b) above, to the manager of the dealer's normal shipping warehouse.

(d) If during the checking of accessories applications by the warehouse, any accessories numbers or quantities appear to be out of line, or if any other irregularities are noted, the applications will be referred back to the Zone Manager for review and final decision.

Establishing New Parts Department

Zone management is responsible for the establishing of a new dealership and they should delegate assignments to determine that the parts department is . . .

Located correctly in dealerships (Page N-10)

Supplied with proper equipment and operating supplies (Page N-11)

Layed-out for efficient operation (Page N-10)

Supported with sufficient capitol investment (Page N-8)

Stocked with a balanced initial inventory (Page N-9)

Informed on identifying and pricing parts (Page N-7 & N-8)

Familiar with Oldsmobile warehousing system (Page N-8)

Informed on parts ordering procedures (Page N-9)

Familiar with inventory control methods (Page N-10)

Informed on transportation procedures (Page N-11)

Familiar with the process of receiving (Page N-12)

Informed on the return of parts (Page N-12)

Discuss the fact that the parts department is an area of merchandising activity . . . that it should radiate an atmosphere of desiring to serve . . . that they have genuine factory merchandise, designed for the original product and warranted by the factory. Explain that parts are usually a demand item but plus sales can often be made if related parts are suggested. Discuss the possibilities of selling at wholesale.

Revised December 2, 1958

N-14A

[fol. 579] Physical Inventory Of Parts

At least once each year, a physical inventory of all parts and accessories should be taken in order that the dollar value can be ascertained and the accounting records reconciled. The "Oldsmobile Physical Inventory Record" is made available to simplify and accelerate the taking of an inventory. It provides printed pages that list the group and part number, name and model usage, price and classification of all parts except factory stocked items. It provides space for writing the quantity on hand and the total price extension which is posted in its respective classification column. It is this classification factor that enables the determining of the sales quality of all items stocked and their relation to the total inventory investment. It informs the dealer of his investment in fast, medium fast, slow moving, factory and unclassified parts by items and dollars.

Return Material Classification Listing

The subject is divided into two volumes of printed pages containing a listing of all parts eligible to return under the Unsalable Parts Return Plan. One book lists all of the "Hold" items and the other "Salvage" items. Both books provide the part numbers in numerical sequence, the noun name, dealer net price, warehouse code and blank spaces for writing in the quantity being returned and the price extension.

The purpose of these listing books is to eliminate the writing of Return Material Applications and to accelerate the processing of returning eligible material under the Unsalable Parts Return Plan.

Warranty Of Parts

There are no warranties, expressed or implied, made by Oldsmobile to Dealer on the Oldsmobile motor vehicles, chassis or parts furnished hereunder except to the extent comprehended in the following:

"The Manufacturer warrants each new motor vehicle, including all equipment or accessories (except tires) supplied by the Manufacturer, chassis or part manufactured by it to be free from defects in material and workmanship under normal use and service, its obligation under this warranty being limited to making good at its factory any part or parts thereof which shall, within ninety (90) days after delivery of such vehicle to the original purchaser or before such vehicle has been driven 4,000 miles, whichever event shall first occur, be returned to it with transportation charges prepaid and which its examination shall disclose to its satisfaction to have been thus defective; this warranty being expressly in lieu of all other warranties, expressed or implied, and all other obligations or liabilities on its part, and it neither assumes nor authorizes any other person to assume for it any other liability in connection with the sale of its vehicles.

"This warranty shall not apply to any vehicle which shall have been repaired or altered outside of an authorized Oldsmobile Service Station in any way so as in the judgment of the Manufacturer to affect its stability and reliability, nor which has been subject to misuse, negligence or accident."

Revised December 2, 1958

N-14B

[fol. 580] Sales Reports

Zone Management is informed each month of the zone's parts sales and stock orders received accomplishments on the "Digest of Parts and Accessories Activities" (PA-128). (See Desk Manual—Operation No. 822).

As monthly stock orders are received from dealers, the G.M.P.D. Warehouse informs zone management the dealer-

ship firm name and city, the type of order received and the number of items ordered. (See Desk Manual—Operation No. 824).

Zone Management is informed each month on "Parts Purchase Record" (PA-35) of each dealership's purchases of parts from Oldsmobile. Form PA-183, "Part Performance Statistics", is supplied to the zone with each dealership name and address printed thereon for maintaining a record of that dealership's parts purchases and monthly order performance.

In order that zone management can discuss sales performance figures with zone personnel, easel and book size charts are supplied for "Parts Pad Performance" (119-E), "Zone Parts Performance" (121-E) and "Zone Accessories Performance" (123-E).

Revised December 2, 1958

[fol. 581] WHOLESALE PARTS COMPENSATION PLAN N-15

The subject plan was modified November 1, 1960. Due to many details and in order to obtain the most current information, reference should be made to the latest "Dealer Price List No. ....." Form 456 Olds, and the booklet "Wholesale Parts Selling Record Procedures" Section VIII, Form PA-284, attached to Zone Managers' bulletin letter dated October 21, 1960.

The forms 456 and PA-284 detail (1) qualified sales, (2) eligible parts, (3) procedure for recording sales, (4) retaining records, (5) applying for compensation and other pertinent data.

ZONE RESPONSIBILITY

When applications for wholesale compensation (Form PA-300) are received from dealers, the following procedure is to be observed.

(1) Determine that the "Report of Qualified Wholesale Sales . . . " and "Credits" (Form PA-301) are attached and correctly posted to the PA-300 form.

(2) Determine that the dealership name, address, code number, period of application and dealer signature are legibly posted on the PA-300 form.

(3) Zone Manager or Assistant Zone Manager, after applications have been checked, should approve and promptly mail to P and A Department.

(4) Once each year, an audit is to be made covering at least one month's business for each dealer who applies for wholesale compensation. This audit is to be conducted by a member of the Oldsmobile Zone Office on Form PA-163. One copy of this audit report is to be mailed to the P and A Department at Lansing and a copy retained in the Dealer File in the Zone Office.

Revised December 16, 1960

[fol. 582] O-III-7

ORGANIZATION AND ANALYSIS

EVALUATION OF DEALER SALES PERFORMANCE

Zone Dealer Performance Record, Form 464A-Olds, is designed to evaluate sales performance in each single-dealer point and for the total of each multiple-dealer area.

To evaluate the sales performance of a dealer in any multiple-dealer area, the supplementary Form 464B-Olds must also be employed, as, under the terms of the Selling Agreement, the sales of such a dealer must be evaluated against its agreed Standard of Sales Participation.

Zone Managers have reached agreement with all dealers in multiple-dealer areas as to their individual Standards of Sales Participation (dealer Planning Potential % of Metropolitan Total, "Development of Planning Potential for Multiple Metropolitan Area Dealer Points," Form Olds 434-C) and confirmed this agreement using standard letter OA-37. In the event of appointment of a new dealer in any multiple-dealer area, such agreement and confirmation are required with the new dealer. Also, in the event of the change of any metropolitan area from a single-dealer point to a multiple-dealer point, then agreement to and

confirmation of the Standard of Sales Participation are required with each dealer in the area. Obviously, new agreements and confirmations are also required if for any reason any agreed Standard of Sales Participation is changed.

Forms 464A-Olds and 464B-Olds conform to the terms of the Selling Agreement as it specifies criteria to be employed and all data specified is essential to that conformity. These forms must be maintained on each dealer which has a planning potential of 100 or more; it is recommended that the forms also be maintained for smaller dealers where sales deficiency is sufficiently great to justify keeping the record.

A thermo-fax copy of each Form 464A-Olds or Form 464B-Olds maintained by the Zone is to be furnished to the Organization and Analysis Department as promptly as possible after data is posted for each quarterly period ending March 31, June 30, September 30 and December 31 of each year.

Revised January 30, 1960

[fol. 583]

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SECTION Q

ADVERTISING

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Revised August 31, 1959

[fol. 584] Q-1

ADVERTISING & PROMOTIONAL FUND PLAN

In order that Oldsmobile dealers may be assured the benefits of comprehensive advertising of Oldsmobile products, without provision for dealer contributions, Oldsmobile agrees to establish, pay for, and maintain an Oldsmobile Advertising and Promotional Program and to administer

such program, on substantially the same national and local basis as heretofore provided in the Selling Agreement, to promote the sale of Oldsmobile products for the mutual benefit of Oldsmobile and Oldsmobile dealers.

Oldsmobile undertakes to make provision for an Advertising and Promotional Program reserve account in an aggregate amount on the basis of the amount per motor vehicle and chassis set forth in the Oldsmobile Dealer Price List under the heading "Advertising and Promotional Program" for all new Oldsmobile motor vehicles and chassis sold and delivered by Oldsmobile to Oldsmobile dealers. This account will provide for the cost of the Oldsmobile Advertising and Promotional Program.

The provisions of the Advertising and Promotional Program may be modified from time to time to limit or to broaden the application and coverage of such program. Moreover, the amount per Oldsmobile motor vehicle and chassis referred to in the above paragraph may be increased or decreased from time to time with the announcement of new yearly model vehicles to compensate for increases or decreases in advertising and other costs and for modifications in the program.

The Oldsmobile Division handles for its dealers the preparation and placement of local advertising, maintaining direct supervision, as well as exercising due care and diligence in the general administration of the Advertising and Promotional Fund.

Operation of the Advertising & Promotional Fund Plan

Upon receipt of the Dealer Appointment Notice at the Home Office, the Advertising Department immediately registers the appointment in its records. Then a local Oldsmobile advertising schedule is established to maintain an Oldsmobile Advertising and Promotional Program and to administer such a program in keeping with the dealer's sales in his area of responsibility.

Media-Advertising

Under the Advertising and Promotional Fund Plan, the eligible media for the Advertising and Promotional Fund is as follows:

Standard Daily Newspapers	Motion Pictures (Screen)
Standard Weekly Newspapers	Painted Bulletins
Outdoor Posters and Signs	Television (Local)
Radio (Local)	Direct Mail

Revised August 31, 1959

Q-2

[fol. 585] Publications used in connection with a Newspaper schedule must have paid circulation. Media with free circulation and those associated with religious, labor or fraternal organizations are not considered eligible to carry any part of a dealer's schedule.

NEWSPAPER ADVERTISING

All New Car Newspaper Advertising will be planned, scheduled and released by the Advertising Department, and such newspaper advertising appearing locally in the dealers' territory will, whenever practical, carry the name and address of the local dealer as shown on the Dealer Appointment Notice and Record Sheet, Form 401-Olds.

In cities where more than one dealer is situated, New Car Newspaper Advertising will carry the names of all dealers, providing the size of the advertisements makes the listing of all dealers practical. If it is not practical to list the names of all the dealers, a general imprint such as, "See Your Local Authorized Oldsmobile Quality Dealer," will be used. Where one or two dealers' names are to appear in an advertisement, the names will be typed on the insertion order. Where more than two names are to appear, a list of the correct names will accompany the insertion order, and the publisher will be instructed to contact a designated Dealer whose name will appear on the insertion order and secure approval of the dealer names. In Zone Office cities, the publishers will be instructed to contact the Zone Office for the approval of the dealer imprints. Oldsmobile, however, reserves the privilege of omitting dealer imprints,

when such a procedure appears justifiable because of size of space being used, and will substitute a suitable reference.

General Procedure Used By Advertising Department for Ordering Newspaper Advertising

Oldsmobile newspaper advertising is placed at the General Motors Contract Rate, by our Advertising Agency, D. P. Brother & Co., 4th Floor, General Motors Bldg., Detroit 2, Michigan. The agency will issue necessary insertion orders. All advertising copy must be run as scheduled by the insertion order.

In order that dealers and Zone Offices may be thoroughly familiar with the advertising scheduled, the insertion orders for the month are distributed as follows:

PUBLISHER'S COPY goes to the newspaper with proofs of the ads attached, authorizing the insertion on the dates specified.

ZONE OFFICE COPY goes to the Zone Office informing the Zone Manager of the Advertising that has been ordered for each dealer in the Zone.

DEALER'S COPY with proof of ads attached goes to the dealer, advising him of the advertising scheduled.

Revised August 31, 1959

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[fol. 586] Local Radio and Television, Outdoor, Painted Bulletin and Movie Trailer Advertising

The same procedure will be followed when any of the above media is placed at the General Motors Contract Rates. The payment of the advertising will be handled direct with the advertising media by the advertising agency.

New Dealer Announcement Advertisement

New dealer announcement advertisements are scheduled by the Advertising Department for dealers appointed in single dealer cities as the appointment notices are received. No new dealer announcement advertisement is scheduled for a multiple group or metropolitan area dealer at the time of his appointment. In the case of single dealer points, the advertisement is scheduled on a "Date from Dealer"

basis, the dealer scheduling the advertisement when he has a car on display.

Oldsmobile Division wishes to discourage requests for special announcements. The preparatory cost of such announcements is expensive, and unless it is a very unusual condition the standard new dealer announcement advertisement is recommended. Zone Offices are also requested to refrain from asking for announcements for dealers in Metropolitan cities where more than one dealer is located. The cost of inserting an announcement in large Metropolitan newspapers is excessive, especially considering the fact that the entire circulation of the paper must be purchased in order to reach the new dealer's own community, which generally is a small part of the newspaper's total market.

If a case arises where, in the opinion of the Zone Office, an exception should be made to this rule, special request should be directed to the Advertising Department. Such announcements, if approved, will provide a space for listing the names of other dealers located in the city. Names will be supplied the newspaper by the Advertising Department, and should be checked and approved by the Zone Office or a designated Dealer when proof is submitted by the newspaper.

New Car-New Building Advertisement

A standard New Car-New Building advertisement is available for announcing a dealer's new building. The Zone Office should request this advertisement by letter, giving approximate date dealer wishes to have the advertisement inserted. This advertisement will be scheduled on a Date From Dealer basis so that the advertisement will coincide with the opening of the dealer's new building.

Special Advertisements

At various times dealers will require "Open House", "Fair", or "Automobile Show", advertisements to coincide with the dealer's participation in this type of activity. Standard advertisements are prepared for these events. The Zone Office should inform the Advertising Department

when a dealer requires a special advertisement giving the Advertising Department the date of the event.

Revised August 31, 1959

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[fol. 587] NEW DEALER KIT

New dealer kits containing certain Advertising and Promotional items along with other Sales Department materials are available on a "no charge" basis for distribution to new dealers when they are signed.

The contents of this package should be checked over thoroughly by the dealer, orders for additional quantities of the materials should be ordered from the Zone Office or direct from the source of supply as marked on the items. These kits are shipped directly to the dealer upon written advice from the Zone Office. (See Organization & Analysis Section of this Manual for ordering of Kits).

AUXILIARY DEALER ADVERTISING HELPS

Many dealers who recognize the value of advertising their own individual dealerships regularly pay for their own special advertising.

For such dealers, Oldsmobile Division produces special advertisements on used cars, service, parts and accessories. Mats or stereotypes of these advertisements are available at the Advertising Department, Oldsmobile Division. Proofs and order blanks or the actual mats are sent to dealers at various times and all advertisements are properly identified by number.

In addition to newspaper advertisements, radio recordings, radio scripts, television film shorts, movie trailers and outdoor 24-sheet paper, with dealer imprint, are all furnished to the dealers at no charge. The above materials may be obtained for dealers upon request from the Zone Office.

SPECIAL NEWSPAPER SECTIONS

Experience, surveys and studies have repeatedly shown that the most desirable space for regular Oldsmobile news-

paper advertising is located in the main news sections of the newspapers.

Newspapers often promote special sections of their paper for various reasons, usually for their own profit or prestige. While the value of the local newspaper space is recognized, Oldsmobile prefers to have factory-prepared copy appear where the dealer and Oldsmobile will derive the greatest benefit. We, therefore, will discourage requests for Oldsmobile advertisements to appear in special newspaper editions.

DEALER LISTINGS IN TELEPHONE DIRECTORIES

Oldsmobile Division has made arrangements for trade mark listings to appear in all telephone directories in all Oldsmobile Dealer Points, regardless of population, which have a classified "Where to Buy It" section. This service is available when a dealer purchases a bold-faced listing of his name in the main section of the telephone directory.

Only authorized Oldsmobile Dealers' listings (name, address and telephone numbers) will appear in the "Where to Buy It" classified section. Unauthorized dealers will be unable to obtain listing under the Oldsmobile Trade Mark Heading.

The local telephone companies or their agent will solicit newly appointed dealers to obtain their order for a listing under the Oldsmobile Trade Mark Heading, at the regular local listing rate.

Revised August 31, 1959

Q-5

[fol. 588] HAND-OUT LITERATURE

Literature will be distributed from the Advertising Department to all dealers at several periods during the year, according to requirements. The quantities of literature allocated to each dealer will be determined by the Advertising Department. Details pertaining to the method of distribution employed will be furnished the Zone Office at the time of each general distribution of literature to dealers. Literature furnished to dealers through the above distributions is supplied at no cost with transportation charges prepaid.

Rate schedules for Oldsmobile literature will be determined yearly for additional quantities of literature requested over and above the regular shipments provided by Oldsmobile.

WINDOW TRIM AND SHOWROOM POSTERS

Window Trims and Decorations, Complete Line Posters, Mechanical Features Posters, and such other showroom material as the Advertising Department may decide upon, are furnished to all dealers at no charge.

DEALER IDENTIFICATION SIGNS

In the Oldsmobile Selling Agreement, which each Direct Dealer signs, is the following clause:

The dealer agrees, in case he has not already done so, to immediately purchase, erect and maintain, at his expense, the following sign as hereinafter specified:

A product electric sign in a conspicuous place outside his showrooms, provided the erection thereof is not prohibited by municipal ordinance or state statute.

A standard authorized service sign in a suitable location on the outside of the dealer's place of business.

Such other signs as are necessary to properly identify his business on a basis mutually satisfactory to both Seller and Dealer.

The Home Office furnishes each Zone with a brochure outlining recommended signs which a dealer may purchase directly from the sign company, or a dealer may elect to purchase his sign locally.

Regardless of the sign supplier, whether it be local or from the brochure, it is the responsibility of the Zone organization to see that each dealer complies with the sign clause of his Selling Agreement.

All orders for Electric Product Signs, Firm Name Signs, Interior & Exterior Service Signs, Used Car Lot Signs, etc., should be placed in accordance with the instructions

in the Oldsmobile Sign Catalog, or special brochures on Used Car Lot Signs.

Instructions as to whom the dealer checks should be made payable, will be found in the Price Sheet accompanying the above mentioned catalogs. Also, detailed information is given as to the time payment plans available for dealer identification signs.

Revised August 31, 1959

Q-6

[fol. 589] TESTIMONIAL RELEASE

The name, photograph or likeness, or any reproduction thereof, of any employe can be used for the purpose of advertising, publicity, trade or similar purposes only after the written consent of the employe or person concerned has been secured.

It is the policy of the company to make no offer or promise of a monetary reward for the use of an employe's name, photograph or likeness.

A witnessed signature on Form Olds-1514 shall be secured from each employe whose name, photograph or likeness is to be used, provided that employe is of legal age.

This same Form, Olds-1514, shall be used for securing a witnessed signature of persons not employed by this company whose name, photograph or likeness is to be used by this company for advertising, trade or similar purposes.

It should be ascertained that the person whose name or picture is being used is of legal age, or if not of age, the signature of a parent or guardian secured.

This procedure applies to company publications, etc., and does not pertain to the use of professional models, actors, etc., hired for the use of their names, photographs or likenesses. (See Desk Manual—Operation No. 1600).

The following is a facsimile of Form Olds-1514:

Olds-1514

Street ..... City ..... State .....

Date .....

FOR VALUE RECEIVED, I HEREBY CONSENT to the use of my name and/or likeness of me however created, as well as reproduction in any form with or without alterations or omissions, by Oldsmobile Division, General Motors Corporation, for the purposes of advertising, for the purposes of trade or for such purposes of a similar or different nature as Oldsmobile Division, General Motors Corporation may choose.

I am over the age of 21 years.

This license is irrevocable.

Signed .....

Witness: .....

Revised August 31, 1959

Q-7

[fol. 590] WINDOW TRANSFERS

Orders for Trade-Mark Window Transfers should be filled FREE by the Zone Office from their stock secured from the Advertising Department, Lansing.

PROCEDURE FOR PURCHASING PHOTOGRAPHS FOR THE ADVERTISING DEPARTMENT

The following five steps should be used in ordering photographs as requested by the Home Office Advertising Department:

Request and secure supplier's invoice in duplicate. The invoice is to be made out to Oldsmobile Division, General Motors Corporation, Lansing, Michigan.

Description of the material and purpose for which it is to be used is to be entered on both copies of the invoice.

The Zone Office is to approve both copies of supplier's invoice.

Both copies of supplier's invoice are to be mailed to the Advertising Department.

Zone offices are not to issue purchase orders or checks to cover the above. As previously mentioned, the Home Office will pay the invoice.

Revised August 31, 1959

[fol. 591]

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SECTION R

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Revised October 12, 1959

R-1

[fol. 592]

SALES PROMOTION PROGRAM

The Sales Promotion Department handles these promotional activities, programs and materials designed to aid Oldsmobile's wholesale and retail organizations to secure new and used car sales at retail in line with national objectives.

In the Zone, it is the direct responsibility of the Assistant Zone Manager, under the direction of the Zone Manager, to supervise the Sales Promotion activities and programs initiated by the Home Office Sales Promotion staff. It is also his responsibility to devise and operate promotional programs of his own upon approval of Zone Manager and as required by the Zone sales position.

The District Manager is responsible for the execution of Sales Promotion activities and programs in his territory whether initiated by the Home Office sales promotion staff or by the Zone Office.

The Sales Promotion Field of Operation

1. *Retail Sales Manpower*—Sufficient retail salesmen under competent sales management to sell the volume of new and used cars required to attain Oldsmobile's national objectives. (See Sales Manpower Requirements" Page R-2.)
2. *Retail Sales Training*—Develop and maintain a continuing sales training program, covering Oldsmobile products, competitive information and sound selling methods for use by the dealers' sales organization.
3. *Retail Selling Equipment*—Design and supervise production of required selling equipment and point-of-sale materials for use at dealership level.
4. *Sales Stimulation Programs*—Plan and organize special sales incentive campaigns, as dictated by market conditions, in order to reach sales objectives.

5-Point Program for Sales Action

A program designed to make sure that Oldsmobile dealerships are equipped with the Five Basic Requirements for Selling, as follows:

1. *Retail Sales Manpower*—The establishment of sales manpower (Sales Managers, Salesmen) requirements in each dealership based on sales potential, agreed to by the dealer, and the hiring of qualified men to meet these requirements.

2. *Demonstrators*—Agreement with dealers that the first essential sales tool is a current model demonstrator and that every new car salesman should have his own demonstrator.

Reissued October 12, 1959

R-2

[fol. 593] 3. *Prospect System*—To have in operation in every dealership with two or more salesmen an approved Prospect System, or it's equivalent. (See Desk Manual—Operation No. 1708)

4. *Sales Activity Board*—To have in operation in every dealership employing two or more salesmen a sales activity board maintaining a day-to-day record of selling work done in relation to sales objectives. (See Desk Manual—Operation No. 1709)

5. *Sales Meetings*—To establish in every dealership having two or more salesmen a planned schedule of daily sales check-up meetings as well as periodical sales training meetings.

Sales Manpower Requirements

Sales Manpower requirements are to be periodically reviewed and revised upward or downward as the situation demands. (See Desk Manual—Operation No. 1700)

The sum total of dealership manpower requirements is the Zone's quota of retail sales managers and salesmen.

Dealer Sales Management

The responsibility for Sales Management must be assumed by one individual in every franchised Oldsmobile dealership employing one or more retail salesmen. In smaller dealerships employing from one to four salesmen, or in dealerships having two or more partners, it is conceivable that the dealer or a partner could assume the responsibilities of the job of sales manager. But, outside of these few exceptions, which should be carefully scrutinized by the Zone personnel, dealers should employ sales managers

capable of hiring, training and supervising the retail organization to the end that the dealership's established sales objectives will be reached.

Retail Sales Training (See Dealer Meeting Service Program Page R-3)

Good salesmen are well trained salesmen, trained on the product and trained in modern selling methods.

The training of retail salesmen is primarily the responsibility of the dealer or his sales manager. *However, it is the District Manager's responsibility to assist Oldsmobile dealers in planning and placing into effect a continuing training program in all dealerships.*

Retail salesman training can be placed in two classifications—preliminary or induction training for newly hired personnel and continuous training to keep all sales personnel up-to-date on product and selling methods.

When required, special retail sales training activities are conducted under the supervision of the Sales Promotion staff. The materials required for such programs are developed and produced by the Home Office. The necessary materials and special instructions for the conducting of training programs are furnished to the Zone Office. It is the Assistant Zone Manager's responsibility to schedule the training meetings, instruct the District Managers on

[fol. 594] the content and use of the materials for the training meetings and to assist District Managers in conducting the meetings.

New Car Sales Aids

Oldsmobile believes that every dealer, sales manager, new car salesman and new and used car combination salesman, should have a complete set of sales equipment. Each year the Home Office Sales Promotion staff is responsible for the preparation of certain selling equipment covering the following sales requirements:

1—A Feature Folio containing illustrations of current models and sales features.

2—Mechanical specifications, detailed product data and mechanical illustrations of current model Oldsmobiles.

3—Samples of current paint colors and upholstery offerings.

4—Point-of-sale materials such as banners, car pictures, etc.

5—Promotional items such as post cards, book matches, direct mail pieces, business cards, etc.

Salesmen's equipment and other showroom "point-of-sale" materials offered from year-to-year are produced under the supervision of the Sales Promotion Department and are sold to dealers at cost. Special order forms are provided for securing dealer orders. A letter of instruction to Zones is issued at the time covering all details regarding orders, prices and settlement. When additional books or "Point-of-Sale" showroom materials are desired for purchase by dealers, they are to be ordered from the Sales Promotion Department in Lansing or direct from the supplier if so instructed by general letter. (See Desk Manual —Operation No. 1701)

Sales Stimulation Programs

An important responsibility of Sales Promotion is the creation, production and carrying out of stimulating activities designed to maintain the interest and arouse the enthusiasm of the retail selling organization and, when the occasion demands, through special campaigns or contests to inspire the organization to peak effort in order to attain definite sales objectives.

Whenever such activities are initiated by the Home Office, general letters are sent to Zones covering the objectives of the programs and containing detail instructions for Zone handling. It is the responsibility of the Assistant Zone Manager under the direction of the Zone Manager to handle all details in connection with such activities and to see to it that the activity receives the full support of the District Managers and dealer body.

Dealer Meeting Service Slidefilm Program

This activity—which is a part of the Retail Sales Training Program—is designed to provide Oldsmobile dealers with timely sales training and product slidefilms on a regular monthly basis.

Revised October 12, 1959

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[fol. 595] Dealer Meeting Service Slidefilm Program

This service, also known as the PIP Program (Profit Insurance Program), is offered to dealers on a subscription basis for which they are billed quarterly on their Oldsmobile parts account statement. (See Desk Manual—Operation 1702)

Sales Promotion Publications

One Sales Publication is released on a regular basis by the Sales Promotion Department.

Oldsmobile "Rocket News"—a newspaper type publication, issued monthly. Of particular interest to the retail salesman, this paper contains selling slants on the product as well as successful selling methods used by Oldsmobile salesmen. (See Desk Manual—Operation No. 1703)

Owner Lists, Oldsmobile and Competitive

Every Oldsmobile dealer should maintain an Owner List for follow-up and promotional purposes. (See Desk Manual —Operation No. 1704)

It is also recommended that a competitive owner list be secured and used to promote sales.

Dealer Stationery

Oldsmobile Division, as a service to dealers, has made available through cooperating suppliers, dealers' stationery in various styles and sizes of letterheads, envelopes, business cards, etc. (See Desk Manual—Operation No. 1705)

Advertising Specialties and Other Dealer Helps

Oldsmobile, each year, in cooperation with various suppliers, develops general promotional items for dealers' use. (See Desk Manual—Operation No. 1706)

Retail Order Pads and Other Dealer Sales Management Forms

Standard Retail Order Pads and other forms such as New Car Stock Lists are made available to dealers through an independent supplier. Form OSP-102, Dealer's Order for New and Used Car Selling Material is furnished for placing such orders. (See Desk Manual—Operation 1710)

Product and Firm Name Signs

Approved Dealer Building signs are made available to dealers through recognized sources.

Special brochures and order blanks have been furnished to dealers and Zones describing these sign programs. Additional copies may be obtained by writing to the Sales Promotion Department at Lansing. (See Desk Manual—Operation No. 1707)

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[fol. 596] Special Product Training Meetings

Each year, prior to the national new car announcement, the Sales Promotion Department provides Zones with meeting materials and complete instructions necessary to conduct product training meetings in order to indoctrinate all Oldsmobile retail salesmen with selling facts about the new models before they are introduced to the public.

Generally, these meetings consist of a question & answer period. During this quiz, the retail salesmen compete against one another, vying for prizes which are distributed to those salesmen answering the most questions correctly.

Upon receipt of materials and instructions from the Sales Promotion Department, it is the Zone's responsibility to schedule and conduct such meetings throughout the Zone prior to new car announcement date. (See Desk Manual—Operation 1711)

Oldsmobile Vanguard

The Oldsmobile Vanguard is a sales honor organization designed to give recognition to above average selling performance on the part of Oldsmobile retail salesmen and sales managers. The organization serves as a morale builder and increases the retail selling organization's loyalty toward Oldsmobile. It also serves to stimulate extra selling effort by establishing progressive sales goals.

The program is divided into two parts. One part is devoted to retail salesmen and called the Oldsmobile Rocket Vanguard. (See Desk Manual—Operation No. 1712-1713). The other is aimed at sales managers and is known as the Oldsmobile Sales Manager's Vanguard. (See Desk Manual —Operation No. 1716).

OLDSMOBILE ROCKET VANGUARD FOR SALESMEN

Rocket Vanguard membership is earned when a salesman accumulates a set number of points. Higher rating and additional awards of recognition are achieved as the salesman gathers points over and above the membership requirement. These levels are star ratings going from one to five stars. Awards are made to the salesmen upon reaching the membership level and at each star level. Point requirements for membership and star levels, eligibility requirements, enrollment procedures, awards and other information about the program are contained in the CURRENT Official Rulebook for the Rocket Vanguard.

SALES MANAGERS' VANGUARD

An eligible sales manager earns membership in the Sales Managers' Vanguard when 50 per cent or more of the salesmen in his dealership become members of the Rocket Vanguard. After the sales manager receives his membership, he can earn a higher rank of One to Five stars. Awards of recognition are made to the sales manager after reaching membership status and at each star level.

Eligibility requirements, requirements for membership and star levels, enrollment and reporting procedures and

other information directly related to the program is shown in the CURRENT Official Rulebook for the Sales Managers' Vanguard.

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[fol. 597] *G. M. Manpower Development Program*

The G. M. Manpower Development Program consists of three different types of sales training sessions conducted by General Motors Conference leaders at GM Training Centers, as follows:

A. A Sales Manager's Conference for experienced sales managers.

B. A basic course for New Retail Salesmen with less than one year of experience.

C. An Experienced Salesmen's Conference for men with two or more years of experience.

The Zone Manager will be responsible for estimating and enrolling the potential dealer sales personnel in the Zone for these programs. (See Operation 1717, Desk Manual.)

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[fol. 598]

BEFORE THE DISTRICT OF COLUMBIA TAX COURT

Opinion No. 992

Findings of Fact and Opinion—Filed January 29, 1962

These two cases have been consolidated for hearing and disposition. They involve the same questions of taxation for the calendar years 1957 and 1958. The assessing authority of the District of Columbia assessed the petitioner substantial franchise taxes. The petitioner here appeals from the assessments and claims that they are invalid. The respondent insists that the assessments are proper and justified under Title X of the District of Columbia Income and Franchise Tax Act of 1947.[1]

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[1] Title X of Chapter 15 (Sections 47-1580 and 47-1580a), D. C. Code, 1951 Edition.

FINDINGS OF FACT

Most of the facts are stipulated and, together with exhibits, are found as stipulated.

The Court finds additional facts for the taxable years involved as follows:

1. The petitioner had business establishments in 38 states and the District of Columbia. The principal office or headquarters of the petitioner was in Detroit, Michigan. There was an executive office in New York City in which were located the financial executives of the petitioner.

[fol. 599] 2. (a) The factories of the petitioner were located principally in the states of Michigan, Ohio, Illinois, Indiana, New York, New Jersey, Delaware, Maryland, Missouri, California, and Georgia. There was no factory or assembly plant of the petitioner in the District of Columbia.

(b) Approximately fifty per centum of petitioner's physical properties, including factories, equipment and inventories, and payroll amounts were located or paid in Michigan.

(c) All Cadillac automobiles and all heavy trucks of the petitioner's GMC and Coach Divisions were manufactured in Michigan. In addition, many component parts of automobiles and quantities of Buick, Oldsmobile and Pontiac automobiles were manufactured in that state.

(d) At the petitioner's factory or plant in Maryland there were assembled Chevrolet automobiles for shipment to the District of Columbia and the surrounding states.

(e) At the petitioner's factory or plant in Delaware there were assembled Buick, Oldsmobile and Pontiac Automobiles for shipment to the District of Columbia and the surrounding states.

3. The petitioner in accordance with the statutes of the respective states filed income tax returns and paid income taxes for the taxable years involved as follows:

[fol. 600]

Year	State	Amount
1958	Delaware	$ 127,844.95
1957	Maryland	510,792.31
1958	Maryland	271,425.75
1957	Michigan	8,955,799.55
1958	Michigan	18,130,000.00

4. At a conference between the representatives of the petitioner and of the Finance Officer of the District of Columbia, after notice of the latter's intention to assess the deficiencies here involved, the representatives of the petitioner protested the contemplated assessment and stated that the apportionment made was out of all proportion to the business carried on in the District by the petitioner; and that the formula used was basically unfair because it did not take into consideration or employ factors which were important in the production of income from manufacturing; and suggested that factors other than sales should be employed in apportioning the income of the petitioner and suggested that the property and payroll factors should be considered.

Opinion

The assessing authority of the District of Columbia assessed the petitioning taxpayer deficiencies in franchise tax and interest as follows: for the calendar year 1957 a deficiency of $268,585.40, plus interest of $35,379.40 or a total of $303,964.80; and for the calendar year 1958 a deficiency of $167,468.44, plus interest of $11,860.89 or a total [fol. 601] of $179,329.33. The total amount of both deficiencies, $483,294.13, was paid by the petitioner. These appeals followed. The petitioner claims that the deficiencies and interest in their entirety were erroneously assessed. On the other hand, the respondent contends that they were validly assessed.

For the reasons hereafter stated the Court holds that deficiencies and interest for the two taxable years in the total amount of $327,049.23, were erroneously assessed against, and collected from the petitioner.

Before stating the reasons for the above holdings, the Court will consider and dispose of the constitutional questions raised by the petitioner to the extent that it is empowered so to do.

I

Constitutional Questions

The petitioner has raised two constitutional questions, namely, that in violation of the Constitution (a) the application of the formula results in the taxation by the District of Columbia of values without its borders or taxing jurisdiction, and (b) the provision of the statute which exempts or relieves from taxation those corporations or unincorporated businesses which have no office, warehouse or place of business in the District, while imposing a tax on those who do have an office, warehouse or place of business in the District is unconstitutionally discriminatory. The Court does not believe it can decide those questions be- [fol. 602] cause of the muddled condition of the status of the Court, that is to say, whether it is a court or an administrative agency.

It is clear that Congress attempted to make the Board of Tax Appeals a court, or, at least, take away its administrative function as *"a constituent member of the assessing authority"* by the Act of July 10, 1952, (see third paragraph of Section 47-2402, D. C. Code, 1961 Edition). Such attempt, however, has been held to be abortive.

In *Hosmer* v. *District of Columbia,* 77 U. S. App. D. C. 295, 135 F. 2d 654, 71 W. L. R. 932, Judge Prettyman held that the then Board of Tax Appeals was not a court, but *"a constituent member of the assessing authority."* He held the same in *Hamilton National Bank* v. *District of Columbia,* 85 U. S. App. D. C. 109, 176 F. 2d 624, 77 W. L. R. 1102. After those two decisions Congress attempted, at least, to negative or correct the effect of those decisions by providing in the Act of July 10, 1952, making the Board of Tax Appeals the *"District of Columbia Tax Court," that "the said District of Columbia Tax Court shall not be deemed or held to be a constituent member of the assessing*

or taxing authority of the District of Columbia." In a recent case, *District of Columbia* v. *Brady*, 109 U. S. App. D. C. 324, 288 F. 2d 108, Judge Prettyman, however, held as follows:

> "Moreover, under the Code, the ultimate exhaustion of the *administrative remedy*, i.e., a decision by the Tax Court, an 'independent agency' in the District [fol. 603] Government, or indeed even the filing of an appeal with that Court, precludes the taxpayer from filing suit under his common law remedy. If the exhaustion of the *administrative remedy* is a bar to a common law action *a fortiori* it can in no sense be a condition precedent to such a suit.
>
> "We conclude that Dr. Brady's failure to exhaust his administrative remedy did not preclude his bringing action in the District Court."[2]

The Tax Court of the United States is by the organic Act, a designated administrative agency.[3] In several cases in that Court it was held that it could decide constitutional questions, although serious doubts about that function have been expressed by some of the judges of that Court. This Court is, however, uncertain as to its power to decide a constitutional question and believes that until the matter is more clearly or definitely settled by the United States Court of Appeals or by a declaratory act of Congress, it should not decide the questions, but merely note, as it here does, that the constitutional questions were here raised. The Court, therefore, will decide the other issues presented under the law as it exists.

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[2] It is interesting to note that the same result would have occurred from a holding that the Tax Court was a court and not an administrative agency.

[3] Actually it is a court. There is, and has been for sometime, a movement to have it declared to be a Federal Court.

[fol. 604]

II

The Basis for Taxation

These cases involve franchise taxes imposed by Section 47-1571a[4] of the Code, which provides as follows:

> "For the privilege of carrying on or engaging in any trade or business within the District and receiving income from sources within the District, there is hereby levied for each taxable year a tax at the rate of 5 per centum upon the taxable income of every corporation, whether domestic or foreign."

The question which the Court must answer is: what is the portion of the petitioner's net income that was fairly attributable to the trade or business carried on by it within the District of Columbia during the taxable years involved, 1957 and 1958, and other net income from sources within the District—within the meaning of that part of Section 47-1580[5] reading as follows:

> "* * *. The measure of the franchise tax shall be that portion of the net income of the corporation * * * as is fairly attributable to any trade or business carried on or engaged in within the District and such[6] other net income as is derived from sources within the District; * * *."

[fol. 605] The question presented in these cases relates solely to that segment of the petitioner's business which involves the manufacture of a certain number of automobiles and kindred products outside the District of Columbia and the sale thereof to customers within the District. To use the language of the many regulations, the trade or

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[4] Section 2 of Title VII, D. C. Income and Franchise Tax Act of 1947.

[5] Section 1 of Title X, ibid.

[6] The word "such", apparently was ineptly inserted. It has no meaning or significance.

business contemplated by the Act is "*the manufacture and sale* or *purchase and sale* of tangible personal property." The Commissioners have correctly interpreted the term "trade or business" to include a combination of either "manufacture" *and* "sale" or of "purchase" *and* "sale.". Otherwise, the regulations would have read "manufacture, purchase or sale". (See, among others, Section 10-2(c)(1)(a), Regulations of August 6, 1953.) The regulations in the respect indicated are consonant with the legally established fact that, "income may be defined as the gain derived from capital, from labor, or from both combined" *Strattons Independence, Ltd.* v. *Howbert*, 231 U. S. 399, 415, 58 L. Ed. 285, 34 S. Ct. 136; *Doyle* v. *Mitchell Bros. Co.*, 247 U. S. 179, 185, 62 L. Ed. 1054, 38 S. Ct. 467; *Eisner* v. *Macomber*, 252 U. S. 189, 207, 64 L. Ed. 521, 40 S. Ct. 189. (And we might add "enterprise.") The cases, *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113, 65 L. Ed. 165, 41 S. Ct. 45 and *Bass, Ratcliff and Gretton, Ltd.* v. *State Tax Com.*, 266 U. S. 271, 69 L. Ed. 282, 45 S. Ct. 82, have frequently been cited to support one factor for- [fol. 606] mulas, and in that connection they will be discussed with other similar cases in a later portion of this opinion. At this point they are cited to show that the "trade or business" with which we are here concerned includes both the manufacturing as well as the selling of the merchandise involved; that the net income therefrom is earned by both activities;[7] and that, while net income is not "*realized*" until sale, it is earned in part by the manufacture of the article sold. In the *Underwood Typewriter Co.*, case (254 U. S. at page 120) is the following:

> "The profits of the corporation[8] were largely earned by a series of transactions beginning with manufacturing in Connecticut and ending with sale in other states."

Likewise in the *Bass, Ratcliff & Gretton* case (266 U. S. at page 282) we find this:

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[7] Together, of course, with administrative activities.

[8] Similar to the petitioner herein.

"So in the present case we are of opinion that as the Company carried on the unitary business of manufacturing and selling ale, in which its profits were *earned* by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places—the process of manufacturing *resulting* in no profit until it ends in sale, etc." (Emphasis supplied.)

And as the Supreme Court said in *Hans Rees' Sons* v. *North Carolina,* 283 U. S. 123, 75 L. Ed. 879, 51 S. Ct. 385:

[fol. 607] "Undoubtedly the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits."

III

Regulations and Formula Must Comply with Law

At the outset it should be pointed out that, *legally,* any formula or method for the apportionment or determination of net income taxable by the District must, in respect of multistate businesses, accord with that part of Section 47-1580a[9] of the Code, which is in this language:

"* * * *. If the trade or business of any corporation * * * is carried on or engaged in both within and without the District, the net income derived therefrom shall, for the purposes of this article be deemed to be income from sources *within* and *without* the District. * * * *." (Emphasis supplied.)

In *McCeney* v. *District of Columbia,*[10] 97 U. S. App. D. C. 282, 285, 230 F. 2d 832, 84 W. L. R. 625, Judge Washington,

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[9] Section 2 of Title X, District of Columbia Income and Franchise Tax Act of 1947.

[10] Involved an inheritance tax.

Commenting on the failure of the Commissioners to follow the statute in promulgating regulations, said:

> "Section 47-1601 is explicit that the tax is to be paid on the 'market value' of the interest involved. This [fol. 608] requires, we think, that the actual market value of the interest be determined as nearly as possible. Although Section 47-1607 provides that the value of the remainder interest is to be determined by subtracting from the value of the property the value of the life interests, determined in such manner as the Commissioners' regulations prescribe, *this does not authorize the Commissioners to adopt regulations which result in disregarding the directive of the statute to tax only the market value of the interest. It is axiomatic that administrative rules must be consistent with the statute under which they are promulgated.*" (Emphasis supplied.)

See also: *Manhattan General Equipment Co.* v. *Commissioner,* 297 U. S. 129, 134, 80 L. Ed. 528, 56 S. Ct. 397; *Addison* v. *Holly Hill Fruit Products, Inc.,* 322 U. S. 607, 616, 88 L. Ed. 1488, 64 S. Ct. 1215; *Thompson* v. *Amalgamated Casualty Ins. Co.,* 207 F. 2d 214, 220.

Any formula or method which does not conform to, or comply with the plain and unambiguous directive or mandate of the law is, therefore, not legally permissible. For instance, if a corporation manufactures its products at its only plant in Maryland and sells them in the District, a formula with sales as the *sole* factor would be illegal, because under it the entire net income would be assigned to, or deemed to be from sources within the District. Likewise, if property be the sole factor, the formula would be legally improper, because all of the net income would be thereunder assigned to, or deemed to be from sources in Maryland.

[fol. 609] It is interesting to note that, if the taxpayer has its office, manufacturing plant or other principal place of business in the District and sells some of its products or performs some of its services without as well as within the District, a formula with one factor of sales only does

not necessarily violate the *letter* of the provision of the law that the income must be deemed to be from sources both within and without the District. Examples of that result are *District of Columbia* v. *Southern Railway Co.*, 107 U. S. App. D. C. 285, 277 F. 2d 84, 88 W. L. R. 277; *District of Columbia* v. *Evening Star Newspaper Co.*, 106 U. S. App. D. C. 360, 273 F. 2d 95, 87 W. L. R. 1371; and *Thompson's Dairy, Inc.* v. *District of Columbia*, D. C. T. C., Docket Nos. 1731 and 1733, Opinion No. 988. In those cases a one factor formula was used, but its use resulted in loss of revenue to the District to which it was economically entitled from the use by the taxpayers of property and administrative services within the District. A formula with the factors of property, payroll and sales would have saved that revenue, which no doubt, is why the Finance Officer of the District has repeatedly requested and urged the Commissioners to adopt the three factor formula for consistent use, that is to say, for the taxation of both resident and nonresident taxpayers.[11]

[fol. 610] It should, moreover, be observed at this point that the provision for regulations apply in the statute to instances only where the net income of the taxpayer is "deemed to be income from sources within and without the District." Section 47-1580a of the Code, in part, provides:

> "Where the net income of a corporation or unincorporated business is derived from sources both within and without the District,[12] the portion thereof subject to tax under this article *shall* be determined under regulation or regulations prescribed by the Commissioners." (Emphasis supplied.)

Apparently, where the business is carried on *solely* in the District and the entire net income arises therein regu-

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[11] Formal submission of the three factor formula to the Commissioners and action thereon will appear from the Appendices A, B, and C to this opinion.

[12] That is to say, when the business is carried on within and without the District. See preceding portion of Section 47-1580a of the Code.

lations or formulae are not necessary. They are only needed where the income is to be deemed to be from sources *both within* and *without* the District.

There are two suggestions or insinuations that need comment. The first is that, if all of a corporation's products manufactured outside the District are not sold therein, a one factor formula of sales would meet the requirement of the law, since it could be said that a part of the net income from the (entire) business of the corporation is deemed to be from sources without the District. The fallacy of that idea is due to overlooking the fact that the "trade or business" covered by the act is that relating to the District, which is a combination of "manufacturing and selling" and which is carried on in the manner stated in the *Underwood Typewriter Co.*, and *Bass, Ratcliff & Gretton* cases, above cited, both within and without the [fol. 611] District. To use an extreme case as the acid test, in *Smoot Sand & Gravel Co.* v. *District of Columbia*, 104 U. S. App. D. C. 292, 261 F. 2d 758, 85 W. L. R. 1078, all of the taxpayer's products were manufactured or processed without the District. Ninety-five per centum was sold in the District, and that percentage of its net income was held to be taxable by the District[13] under a one factor formula of sales. If all of the products had been sold, one hundred per centum of its income would have been held taxable by the District under that formula.

The other suggestion is that since *net* income results from the deduction from *gross* income of all expenses, including those relating to manufacturing, the requirement for the apportioning of net income within and without the District, where the business is carried on both within and without the District, is met by reason of such deduction. That suggestion, in the first place, overlooks the fact that all expenses, including that relating to selling the products,

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[13] The U. S. Court of Appeals evidently overlooked the mandate of the statute as to apportioning the income within and without the District, or it may have been influenced by the fact that Smoot Sand & Gravel Company had its principal office in the District where all of its fiscal affairs were handled. Two-thirds, however, of its expenses were incurred in Maryland and Virginia.

are deducted. Moreover, what we are trying to do in these types of cases is to find the locale of the commercial activity and what portion of the net income is fairly attributable thereto. The usual computation of net income involv-
[fol. 612] ing the inclusion of items in gross income and deducting items of expense therefrom is not here involved. For practical purposes what is important in cases of this kind is the determination of what portion of net income results from the use of property, from the activities of administration and the like and from the process of selling.

For the reasons stated the Court does not believe that a one factor formula of sales can, consistent with the Act, be used where, as here, the trade or business involved is the manufacture of tangible personal property without, and the sale thereof within the District.

IV

The *Eastman Kodak Company* and the *Panitz* Cases

A great deal of confusion has arisen concerning a case decided some years ago by the United States Court of Appeals under the old District of Columbia Revenue Act of 1939, namely, *Eastman Kodak Co.* v. *District of Columbia,* 76 U. S. App. D. C. 339, 131 F. 2d 347. In that case this Court, then the Board of Tax Appeals, upheld an income tax against Eastman Kodak Company on the entire net income from sales of its products in the District of Columbia. The amount of net income allotted to the District was computed by assigning to the District that portion of the taxpayer's income as sales in the District bore to sales everywhere. The United States Court of Appeals affirmed that holding. Several things must be kept in mind in rela-
[fol. 613] tion to the *Eastman Kodak Company* case and to these cases. They arose under two differing statutes, namely, the District of Columbia Revenue Act of 1939, and the District of Columbia Income and Franchise Tax Act of 1947, respectively. The taxes imposed on corporations by the two acts are different in several important and essential respects. *Flint* v. *Stone Tracy Co.,* 220 U. S. 107, 55 L. Ed. 389, 31 S. Ct. 342. The former imposed, as far

as corporations were concerned, a pure income tax, while the latter levies a privilege tax, measured, it is true, by net income. The *Eastman Kodak Company* case was decided, certainly in this Court, on the severance theory, that is to say, that no income was earned until the property involved was sold—that "the fruit must be shaken from the tree," to speak figuratively; and that the place wherein the sale took place was where the income was realized. This Court and the Court of Appeals relied upon several Federal cases which were decided before the enactment of Section 119(c) of the Internal Revenue Code of 1939 (February 10, 1939).[14] The Federal law, as it existed earlier, and upon which those cases were based, was essentially the same as the District of Columbia Revenue Act of 1939. Section 119(c) of the Internal Revenue Code of 1939, however, materially changed the Federal law; and provided that income "from the sale of personal property produced [fol. 614] (in whole or in part) by the taxpayer within and sold without the United States, *or produced (in whole or in part) by the taxpayer without and sold within the United States, shall be treated as derived partly from sources within and partly from sources without the United States*", which is substantially what that part of Section 47-1580a quoted above provides, as far as this case is concerned, that is to say, involving the manufacture of personal property *without*, and its sale *within* the District. It is interesting to note that Eastman Kodak Company sought to have the United States Court of Appeals determine the question of tax liability on the basis of the then new Section 119(c) of the Internal Revenue Code of 1939, but that Court refused to do so, and as stated above affirmed the above-mentioned decision of this Court.

It should here be noted that the most important, and indeed, controlling difference between the District law involved in the *Eastman Kodak Company* case and the District of Columbia Income and Franchise Tax Act of 1947 is that the former law did not, as does the latter (Section 47-1580a of the Code) provide that where the taxpayer's

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[14] See the cases cited in Footnote 6, 76 U. S. App. D. C. page 340.

business is carried on within and without the District the net income, for the purpose of measuring the tax, must be deemed to be from sources *within* and *without* the District. Another difference between the 1939 and 1947 District laws is that under the former, since the income was earned [fol. 615] where the sale was made, the passing of title, which usually completes a sale of personal property, was determinative, while under the latter, the passing of title is of no determinative effect, which was due to, or came about by the following. The decision in the *Eastman Kodak Company* case in favor of the District was a Pyrrhic Victory. The manufacturers quickly adopted a plan whereby title and possession of goods shipped from points outside to customers within the District passed to the customers at a point outside the District. The United States Court of Appeals in *Electric Storage Battery Co.* v. *District of Columbia*, 81 U. S. App. D. C. 135, 155 F. 2d 867, set aside a District of Columbia income tax where the title to goods in a f.o.b. shipment passed to the customer outside the District. That and other cases, and the effect of the *Eastman Kodak Company* case and its use by the manufacturers resulted in the promotion by the District of the enactment of the District of Columbia Income and Franchise Tax Act of 1947,[15] which, as far as corporations and unincorporated businesses are concerned, has two principal advantages to the District, namely, nullification of the effect of the passing of title and the elasticity of a franchise tax which could be measured by income attributable to business carried on in the District, regardless of the locale of the sale or the real source of income in the concept of pure [fol. 616] income taxation. Congress did, however, as above observed, provide, as protection for multistate businesses, that where the business was carried on both within and without the District the net income from such business had to be considered income from sources without, as well as within the District.

Panitz v. *District of Columbia*, 74 U. S. App. D. C. 284, 122 F. 2d 61, 69 W. L. R. 891, has been frequently cited in

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[15] Chapter 15 of Title 47, D. C. Code, 1951 edition.

support of a one factor formula of sales. Like the *Eastman Kodak Company* case, the law involved in the *Panitz* case was materially different from the Income and Franchise Tax Act,—even more so. The *Panitz* case arose under the old Business Privilege Tax Act in the District of Columbia Revenue Act of 1937. It simply imposed an excise tax measured by gross receipts from business carried on in the District "without any deduction therefrom on account of the cost of the property sold, the cost of materials, labor or services or other costs * * * or any expense whatsoever." All that was there decided was that a tax on the gross receipts from the commercial activity of sales (as required by the law) in the District was proper. There was no provision in the taxing statute requiring any apportionment, as does the present law, nor any provision similar in the slightest degree to the requirement in the current Act that, if the business is carried on both within and without the District, the net income must be apportioned accordingly. [fol. 617] The provision in Section 47-1580a of the Code providing that, if the trade or business is carried on within and without the District of Columbia, the net income must be deemed to be income from sources without, as well as within the District, has not only been ignored in the regulations, but has received no comment by counsel for the District in their brief in this case, although this Court has repeatedly referred to that provision as not only important, but controlling as well. The Court is at a loss to understand the failure on the part of counsel to discuss the provision in relation to these cases and to the facts stipulated by the parties.

V

Other Cases Cited to Support a One Factor Formula

Several Supreme Court cases have frequently been cited to support a one factor formula in the taxation of net income or gross receipts from unitary businesses or corporations. The cases do support the use of such a formula, *if the particular statute so provides.* In none of the cases did the taxing statute provide, as does the District law, for the apportionment within and without the taxing juris-

diction where the business is carried on within and without that area. The cases, briefly discussed, are the following:

Maine v. *Grand Trunk Rwy. Co.*, 142 U. S. 217, 35 L. Ed. 994, 12 S. Ct. 121. Really not an apportionment case. The [fol. 618] method to be used was specifically spelled out in the Maine statute.

Underwood Typewriter Co. v. *Chamberlain, supra.* Unlike or exactly opposite from the District statute, the Connecticut law specifically provided that, if the business was carried on both within and without the State, the tax should be computed by the use of a one factor formula of property within Connecticut.

Bass, Ratcliff & Gretton, Ltd. v. *State Tax Commission, supra.* The taxing statute provided specifically for a one factor formula of real and personal property in New York.

National Leather Co. v. *Massachusetts*, 277 U. S. 413, 72 L. Ed. 935, 48 S. Ct. 534. Taxing statute specifically provided for use of a one factor formula of real and personal property employed in business in Massachusetts.

It should be added that in respect of the *Underwood Typewriter Co., Bass, Ratcliff & Gretton, Ltd.* and *National Leather Co.* cases the Supreme Court in the *Hans Rees' Sons* v. *North Carolina, supra,* indicated, as did our Court of Appeals in *Smoot Sand & Gravel Co.* v. *District of Columbia, supra,* that the decisions sustaining the one factor formulas turned largely upon the failure of evidence. This is what the Supreme Court said in the *Hans Rees' Sons* case.

> [fol. 619] "* * * *: Evidence which was found lacking in the Underwood and Bass Cases is present here. *These decisions are not authority for the conclusion that, where a corporation manufactures in one state and sells in another, the net profits of the entire transaction, as a unitary enterprise, may be attributed, regardless of evidence, to either state.* In the Underwood case, it was *not* decided that the entire net profits of the total business were to be allocated to Connecticut because that was the place of manufacture, or, in the Bass case, that the entire net profits were to be allocated to New York because that was the place where

sales were made. In both instances, a method of apportionment was involved which, as was said in the Underwood case, 'for all that appears in this record, reached, and was meant to reach, only the profits earned within the State.' The difficulty with the evidence offered in the Underwood case was that it failed to establish that the amount of net income with which the corporation was charged in Connecticut under the method adopted was not reasonably attributable to the processes conducted within the borders of that state; and in the Bass Case the Court found a similar defect in proof with respect to the transactions in New York." (Emphasis supplied.)

New York v. *Latrobe,* 279 U. S. 421, 73 L. Ed. 776, 49 S. Ct. 377. Unlike the District law the New York statute specifically provided that the license fee for a corporation be based upon that proportion of its corporate stock that gross assets employed within the state bore to its gross assets employed everywhere. *It was a corporate stock valuation case.*

Ford Motor Co. v. *Beauchamp,* 308 U. S. 331, 48 L. Ed. 304, 60 S. Ct. 273. Unlike the District statute, Texas Annotated Civil Statute, Article 7084 specifically imposed "a [fol. 620] franchise tax * * * based upon that proportion of the outstanding capital stock, surplus and undivided profits, plus the amount of outstanding bonds, notes and debentures, other than those maturing less than a year from date of issue, as gross receipts from its business done in Texas bears to the total gross receipts of the corporation from its entire business, * * *."

International Harvester Co. v. *Evatt,* 329 U. S. 416, 91 L. Ed. 390, 67 S. Ct. 444. The Ohio statute specifically provided the formula to be used. Incidentally, the Ohio statute provided a *two* factor formula, namely, of property and "business done" in Ohio.

Actually, all that the foregoing Supreme Court cases decided was that the use of the formulas specifically provided in the various statutes did not violate the Constitution.

A state case, *Household Finance Co.* v. *State Tax Com.,* 212 Md. 80, 128 A. 2d 640, relied upon to support the use

of a one factor formula should be briefly discussed. That case really supports the principle that, if business is carried on within and without the District the net income must be deemed income within and without the District. The Maryland statute required the State Tax Commission, in the valuation of corporate stock relating to Maryland, to exclude business and property outside the state. The order of the State Tax Commission did not follow the law. On appeal to the Court of Appeals of Maryland the order of the Commission was modified to comply with the law. [fol. 621] Moreover, a statutory formula or method was provided.

VI

Expert Testimony

Both parties hereto produced expert witnesses in the field of economics. The petitioner's experts testified that in their opinion no income resulted from sales in themselves, but solely from manufacture and administrative activities; and that the proper factors to be used in a formula for the apportionment of net income of a multi-state manufacturing corporation are those of property and payroll. Diametrically opposed was the testimony of respondent's expert witnesses, who were of the opinion that the entire income of such a corporation was earned by sales, and that the only factor to be used in the formula was one of sales. Both sets of witnesses were in error. Income of corporations of the class to which the petitioner belongs results from all three activities. Of course, as observed in the *Bass, Ratcliff & Gretton, Ltd.* case, the income is not realized or received until the sale, but that does not mean that it is not earned as well by the other activities. For the reason stated the Court has made no finding on the subject matter of the experts' testimony. Moreover, the plain and unambiguous directive in the Act concerning apportionment, would seem to render such testimony immaterial.

The Court has made no finding in relation to the testi- [fol. 622] mony of the petitioner's expert witnesses to the effect that the assessment in this case resulted in attributing to the District a percentage of income out of all proportion

to business transacted by it therein, because such testimony was immaterial in light of the *Smoot Sand & Gravel Co.*, case, where it appeared that all of the activities of production occurred, and approximately two-thirds of expenses of operation were incurred outside the District, but ninety-five per centum of the net income was held taxable by the District.

VII

The Gallant Case

District of Columbia v. Gallant, Incorporated —— U. S. App. D. C. ——, 290 F. 2d 745, dealt with a regulation adopted by the Commissioners on August 6, 1953, for the enforcement and administration of the foregoing provisions of the Income and Franchise Tax Act.[16] The portion of the regulation with which we are here concerned is Section 10-2(c). The first sentence comports with the Act. It is the following:

> "If the trade or business is carried on or engaged in *wholly* within the District, the entire net income from trade or business shall be *allocated* to the District." (Emphasis supplied.)

[fol. 623] The next portion of the regulation, Subsection (1)(a) of Section 10-2(c), attempts to prescribe, or has for its sole purpose the prescribing of a formula for the determination of the net income taxable by the District, that is to say, "*fairly* attributable" to any trade or business carried on in the District. The United States Court of Appeals in the *Gallant* case held that the subsection was *valid*, but that it failed in its purpose, or, to use the language in the opinion, "failed to provide a 'formula' as the term is ordinarily understood in the regulation." Later in the opinion is found this language (290 F. 2d at page 748):

> "However, irrespective of the authority of the Assessor, the Tax Court itself cannot be precluded, for lack of a regulatory formula, from determining the

[16] Chapter 15 of Title 47, D. C. Code, 1951 edition.

income which is fairly apportionable to the District. Cf. *McCeney* v. *District of Columbia*, 97 U. S. App. D. C. 282, 230 F. 2d 832 (1956). The Tax Court is, under Section 47-2403, to hear and determine 'all questions arising' on the appeal—here the question of what income is fairly attributable to the District—and it may 'reduce or increase' the assessment as required under its determination of such questions.

"The case is remanded to the Tax Court for further proceedings not inconsistent with this opinion. The Tax Court is directed to determine the amount of the income which is fairly attributable to the District by applying the August 6, 1953, regulations, including if necessary the use of such formula or formulae as the Tax Court deems best suited for determination of that question in this case. * * *."

In Footnote numbered 4, relating to the regulation of August 6, 1953, is the following: "If a valid and pertinent regulation is promulgated by the Commissioners, the Tax Court must obey it and properly apply it." It is not sup- [fol. 624] posed that the Court of Appeals meant that any regulation adopted by the Commissioners relating to the subject matter here involved should be given retroactive effect in face of the well established principle that such cannot be done if, as decided in the *Gallant* case, there was a valid regulation in effect during the prior year. *District of Columbia* v. *Radio Corporation of America*, 98 U. S. App. D. C. 119, 232 F. 2d 376, 84 W. L. R. 918, cert. den., 352 U. S. 845, 1 L. Ed. 2d 51, 77 S. Ct. 44. But assuming that the United States Court of Appeals might have intended an exception or relaxation of the rule and intended that any new regulation be given retroactive effect, as was assumed in this Court's Memorandum on Remand in the *Gallant* case, this Court is of the opinion that, for the reasons stated in that memorandum to which reference is here made to avoid repetition, the regulation adopted by the Commissioners on July 14, 1961, purporting to relate or pertain to the foregoing provisions of the Income and Franchise Tax Act (See Sections 47-1580 and 47-1580a of the Code) is invalid. The principal objection to the July

14, 1961, regulation is that to apply it in this case to the trade or business involved would violate the plain and unambiguous provision of Section 47-1580a of the Code that "If the trade or business of any corporation * * * is carried on or engaged in both within and without the District, the net income derived therefrom shall, for the purposes of this article, be deemed to be income from sources [fol. 625] within and without[17] the District." The Court is of the opinion, therefore, that the use of the July 14, 1961, regulation in this case would be improper.

VIII

The Best Suited Formula

In the light of the *Gallant* case, the Court believes that it is its duty to determine the amount of net income that was fairly attributable to the District of Columbia within the meaning of Section 47-1580 and 47-1580a of the Code, and to use such formula or formulae as will be agreeable to, and not violative of any provisions of those sections. This Court assumes, of course, that the United States Court of Appeals requires that in adopting a formula this Court follow all pertinent provisions of the taxing statute. With that in mind and considering the nature and extent of the trade or business carried on by the petitioner in relation to the District, that is to say, the manufacturer of a certain quantity of products and administrative activities without the District and the sale of those products within the District, the Court is of the opinion that a formula is necessary [fol. 626] for the determination of the portion of petitioner's net income which was fairly attributable to business carried on within the District within the meaning of Section 47-1580 and 47-1580a of the Code; and that the formula best suited for that determination is the following:

> The portion of petitioner's net income fairly attributable to the trade or business carried on or engaged in within the District of Columbia by the petitioner

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[17] It is important to note that the use of the phrase *"within and without the District"* shows that the term "trade or business" includes that which is done without as well as within the District, otherwise the provision would be meaningless or at least, unnecessary, since there would never be any occasion for its use.

during the taxable years 1957 and 1958 shall be determined by multiplying its total net income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

1(a) The property factor is a fraction, the numerator of which is the average value of the petitioner's real and tangible personal property owned or rented and used by the petitioner in the District during the taxable year, except property from which petitioner derived net income subject to direct allocation under the regulations pertaining to the District of Columbia Income and Franchise Tax Act of 1947[18] and the denominator of which is the average value of all the petitioner's real and tangible personal property owned or rented and used during the taxable year.

(b) Property owned by the petitioner is valued at its original cost. Property rented by the petitioner is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the petitioner, less any annual rental rate received by it from sub-rentals.

[fol. 627] (c) The average value of property shall be determined by averaging the value at the beginning and ending of the taxable year.

2(a) The payroll factor is a fraction, the numerator of which is the total amount paid in the District during the taxable year by the petitioner for compensation, and the denominator of which is the total compensation paid everywhere during the taxable year.

(b) Compensation is paid in the District, if:

(i) The individual's service is performed entirely within the District

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[18] For example, real estate rented to tenants, the rents therefrom being "such other income as is derived from sources within the District," within the meaning of Sections 47-1580 and 47-1580a of the Code, the net income from which is taxable separately from that derived from "trade or business." *D. C.* v. *Evening Star Newspaper Co.*, 106 U. S. App. D. C. 360, 273 F. 2d 95, 87 W. L. R. 1371.

(ii) The individual's service is performed both within and without the District, but the service performed without the District is incidental to the individual's service within the District, or

(iii) Some of the service is performed in the District and (1) the base of operations, or, if there is no base of operations, the place from which the service is directed or controlled is in the District, or (2) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in the District.

3(a) The sales factor is a fraction, the numerator of which is the total sales by the petitioner in the District during the taxable year, and the denominator of which is the total sales by the petitioner everywhere during the taxable year.

(b) Sales of tangible personal property are in the District if:

(i) The property is delivered or shipped to a purchaser, including the United States, within the District of Columbia, regardless of the f.o.b. point or other conditions of the sale.

The foregoing formula is, incidentally, substantially similar to the formula provided for multi-state businesses in [fol. 628] the Uniform Division of Income for Tax Purposes Act,[19] and to that recommended by the Finance Officer to the Commissioners in a memorandum dated March 22, 1961, and tentatively approved by the Commissioners on March 30, 1961 (See Appendices "A", "B" and "C" to this opinion.) The formula, however, is adopted, because, in the opinion of the Court, it is intrinsically the best suited under the facts and in view of the nature of the trade or business involved herein.

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[19] Approved, 1957, by the National Conference of Commissioners on Uniform State Laws and by the American Bar Association.

The parties have stipulated facts sufficient for the application of the foregoing formula.

The Court has not overlooked the decision in the *Gallant* case that the regulation providing a one factor formula of sales is valid in that case. That decision, however, must be considered in the light of the circumstances in that case, that is to say, that the taxpayer, Gallant Incorporated, was engaged primarily in "the purchase and sale", and *not* "the manufacture and sale," with its principal office in the District, and sold the tangible personal property involved in that case *within* and *without* the District, which permitted the use of the sales factor only, without violating the *letter* of the directive in the Act that the income had to be treated as earned, or from sources within and without the District, [fol. 629] which would not be true in this case where the products involved were manufactured without but *sold* within the District. The use of the one factor formula in the *Gallant* case did deprive the District of Columbia of some revenue, but not all, so that, strictly speaking as observed above, the formula did not violate the letter of the law. The same is true of the *Southern Railway Co., Evening Star Newspaper Co.* and *Thompson's Dairy, Inc.,* cases.

IX

Computation of Taxes and Interest Due Year 1957

The factors of property, payroll and sales as defined in the formula may be stated as follows:

	Everywhere	District of Columbia	District Percentage
Property[20]	$6,247,160,370	$ 1,360,676	.0218%
Payroll	$2,662,072,037	$ 1,268,180	.0477%
Sales	$9,461,855,874	$37,185,704	.3930%
Combined Percentages			.4625%
Total Percentages divided by 3 (average)			.1542%

[20] The item of "Property" includes both owned and rented property, the latter valued at 8 times the annual rent paid by petitioner.

[fol. 630] The portion of petitioner's net income for 1957 fairly attributable to the business of manufacturing and selling its products carried on within the District is computed as follows:

Total Net Income		$1,312,092,839.00
Three Factor Apportionment Percentage		.1542%
Net Income Apportioned to District	$	2,023,247.00
Plus Other Net Income from Sources in the District		10,320.00
Total Net Income Taxable by District		2,033,567.00
Rate of Tax		5%
Tax Due by Petitioner		101,678.35
Interest from 4/15/58 to 5/20/60 at ½ of 1% per month[21]		13,218.19
Total Tax and Interest Due for 1957	$	114,896.54

Year 1958

The factors of property, payroll and sales as defined in the formula may be stated as follows:

	Everywhere	District of Columbia	District Percentages
Property [fol. 631]	$6,403,673,576	$ 1,326,209	.0207%
Payroll	$2,354,049,741	$ 1,233,787	.0524%
Sales	$7,853,393,381	$32,542,519	.4144%
Total Percentages			.4875%
Total Percentages divided by 3 (average)			.1625%

The portion of the petitioner's net income for 1958 fairly attributable to business carried on within the District of Columbia by the petitioner is computed as follows:

[21] Section 47-1589c(b), D. C. Code, 1951 Edition, Supplement VIII, providing for interest on interest does not apply because the amount assessed and demanded was exorbitant.

Total Net Income	$653,396,893.00
Three factor Apportionment Percentage	.1625%
Net Income Apportioned to District	$ 1,061,769.00
Plus Other Net Income from Sources in the District	15,418.00
Total Net Income Taxable by District	$ 1,077,187.00
Rate of Tax	5%
Tax Due by Petitioner	$ 53,859.35
Interest from 4/15/59 to 5/20/60 at ½ of 1% per month[22]	$ 3,770.15
Total Tax and Interest Due for 1958	57,629.50

[fol. 632]

X

Computation of Refund

Year 1957

The amount of franchise tax and interest for the year 1957 to be refunded to the petitioner is computed as follows:

	Tax	Interest	Total
Originally and Voluntarily Paid by Petitioner	$ 4,198.70	None	$ 4,198.70
Deficiency Paid by Petitioner	268,585.40	$35,379.40	303,964.80
Total Paid by Petitioner	$272,784.10	$35,379.40	$308,163.50
Amount Due by Petitioner	101,678.35	13,218.19	114,896.54
Refund Payable to Petitioner	$171,621.85	$22,228.15	$193,850.00

[22] Section 47-1589e(b), D. C. Code, 1951 Edition, Supplement VIII, providing for interest on interest does not apply, because the amount demanded in the assessment was exorbitant.

[fol. 633] Year 1958

The amount of franchise tax and interest for the year 1958 to be refunded to the petitioner is computed as follows:

	Tax	Interest	Total
Originally and Voluntarily Paid by Petitioner	1,500.00	None	$ 1,500.00
Deficiency Paid by Petitioner	167,468.44	$11,860.89	179,329.33
Total Paid by Petitioner	$168,968.44	$11,860.89	$180,829.33
Amount Due by Petitioner	53,859.35	3,770.15	57,629.50
Refund Payable to Petitioner	$115,109.09	$ 8,090.74	$123,199.83

XI

Conclusion

For the reasons hereinbefore stated the Court holds as follows:

Docket No. 1698. That a deficiency in franchise tax for the calendar year 1957 in the amount of $171,621.85, and interest thereon in the amount of $22,228.15, or a total of $193,850.00, were erroneously assessed against and collected by the respondent from the petitioner; and that the petitioner is entitled to a refund thereof with interest [fol. 634] thereon at the rate of 4 per centum per annum from May 20, 1960, to the date of the payment of the refund.

Docket No. 1699. That a deficieney in franchise tax for the calendar year 1958 in the amount of $115,109.09, and interest in the amount of $8,090.74 or a total of $123,199.83, were erroneously assessed against, and collected by the respondent from the petitioner; and the petitioner is entitled to a refund thereof with interest thereon at the rate

of 4 per centum per annum from May 20, 1960, to the date of the payment of the refund.

Decisions will be entered for petitioner.

Jo. V. Morgan, Judge.

[fol. 635]

APPENDIX "A" TO OPINION

GOVERNMENT OF THE DISTRICT OF COLUMBIA
DEPARTMENT OF GENERAL ADMINISTRATION

Finance Office

March 22, 1961

MEMORANDUM TO THE COMMISSIONERS, D. C.

(Through the Director of General Administration)

SUBJECT: Proposed amendment to the Income and Franchise Tax Regulations implementing the District of Columbia Income and Franchise Tax Act of 1947, as amended.

It is recommended that the Commissioners approve the attached proposed amendment to Subsection 10.2-(c)(1) of the Regulations pertaining to the District of Columbia Income and Franchise Tax Act of 1947, as amended. Subsection (1) of Section 10.2-(c) relates specifically to the methods to be employed in determining the portion of net income to be apportioned to the District in the case of a corporation or unincorporated business deriving income from sales of tangible personal property both within and without the District.

The District of Columbia Income and Franchise Tax Act of 1947, as amended, imposes a tax upon the taxable income of every corporation and unincorporated business, whether domestic or foreign (unless expressly exempt under the Act), for the privilege of carrying on or engaging in any trade or business in the District and of receiving income from sources within the District. "Taxable income" is defined in the Act to mean "the amount of net income

derived from sources within the District within the meaning of Title X" of the Act.

Section 2 of Title X of the Act provides, in pertinent part, as follows:

"Where the net income of corporation or unincorporated business is derived from sources both within and without the District, the portion thereof subject to tax under this article shall be determined under regulation or regulations prescribed by the Commissioners."

[fol. 636] The present sales regulation was promulgated by the Commissioners in 1953 and provides for apportioning the net income of corporations engaged in selling tangible personal property both within and without the District in the ratio that District sales bear to sales everywhere. The present regulation defines the phrase "District sales" to mean:

> "* * * all sales to District customers the income from which is fairly attributable to the trade or business carried on or engaged in within the District, including solicitation in the District by salesmen or other representatives of the taxpayer, that portion of sales to customers outside the District the income from which is fairly attributable to the trades or business carried on in the District, and sales of tangible personal property the income from which is from District sources."

The foregoing regulation has been found to be both inequitable and unworkable not only at the administrative level but by the District of Columbia Tax Court. In *Smoot Sand and Gravel Corp.* v. *District of Columbia,* D.C.T.C. Docket No. 1340, decided September 4, 1957, the District of Columbia Tax Court, speaking of the present sales regulations, stated:

> "It will be noticed that the formula attempts to deal with three situations. The first involves sales to customers within the District of Columbia, the income from which is 'fairly attributable etc.,', the second, to customers *outside* the District, the income from which is 'fairly attributable etc.' and the third, 'sales of tan-

gible personal property the income from which is from District sources.' When it is considered that the stated purpose of the formula is to determine what is 'fairly attributable to trade or business,' and what is 'derived from sources in the District' the formula is meaningless. It is like saying 'fairly attributable' income is 'fairly attributable' income, and income derived from District sources is income derived from District sources."

[fol. 637] And Lo! The Phantom Caravan has reached The Nothing is set out from—.

"There is no standard, no test, no yardstick, as in the earlier regulations, by which it may be determined what business activity will produce income that can be said to be 'fairly attributable to any trade or business' in the District. The provision in the regulation that 'District sales' include 'solicitation in the District by salesman or other representatives of the taxpayer' does not cure the defect, since there are many other activities connected with, or related to sales."

In a series of cases following the foregoing decision, the District of Columbia Tax Court has consistently refused to apply the present regulation. Needless to say, it has become virtually impossible to deal with taxpayers such as General Motors Corporation, General Foods Corporation, the Lever Brothers Company, Radio Corporation of America, Ford Motor Company, and every other corporation, large and small alike, in the face of the position taken by the Tax Court and the resulting nebulous status of the present sales regulation.

On February 7, 1961, there was forwarded to the Commissioners, D. C., through the Director of General Administration, a proposed amendment to Section 10.2-(c) of the Income and Franchise Tax Regulations. That amendment contained, *inter alia,* a new three-factor formula, composed of property, payroll and receipts, for apportioning to the District a fair and reasonable portion of the net income

of service-type businesses which operate both within and without the District. What we said there concerning the use of a three-factor formula as opposed to a single-factor formula is equally applicable herein. Suffice to say that a three-factor formula consisting of property, payroll and sales is the most accurate and equitable method yet devised for apportioning among the States the taxable net income of corporations operating in a number of States. In cases involving questions of apportionment of income of multi-state businesses, the Supreme Court of the United States has stated many times that arithmetical accuracy is not possible in this difficult area of taxation, and mathematical precision is not required.

The three-factor formula set forth in the proposed amendment has been enacted or recommended for enactment, in whole or in part, by some twenty states, and is gaining [fol. 638] widespread recognition as the most effective and accurate method yet conceived for apportioning business income among the several taxing jurisdictions. It has been endorsed for use by all of the States, on a uniform basis, by most, if not all, of the major associations of State assessors and tax administrators, and by the House of Delegates of the American Bar Association.

While it is not possible to estimate with any degree of accuracy the revenue effects of the adoption of the proposed three-factor formula, its adoption will bring about some decrease in revenue. This decrease in revenue will be offset to some extent by the increase in revenue anticipated among the adoption and application of the three-factor formula relating to service-type business. Also, it is believed that the adoption of the three-factor formula contained in the proposed amendment will produce certain tangible and intangible economic benefits. Corporation have been moving their offices from the District at an alarming rate over the past several years chiefly, we believe, in an effort to avoid liability for payment of District corporation franchise taxes. It is believed that most of the corporations which have removed their offices from the District have done so because of the inequitable results flowing from the application of the present single-factor sales formula, and

would not have done so if the District had had in effect a three-factor formula for measuring the amount of their taxable income to be apportioned to the District. If by the adoption of the proposed amendment large corporations can be persuaded to remain in the District, or to move their offices into the District, it follows that the District will benefit therefrom not only tax-wise, but in many ways. The whole Economy of the District would be revitalized, and a dangerous trend would have been stemmed. In addition, several states which anticipated a loss of revenue prior to the adoption by them of such a three-factor formula have reported that such loss was not in fact incurred.

Under the proposed amendment the property and payroll factors for sales corporations are, with one minor exception, the same as the property and payroll factors for service-type corporations. Generally, the sales factor attributes to the District of all sales of tangible personal property delivered or shipped to a purchaser within the District. Sales of tangible personal property to the United States Government are separately considered in accordance with the provisions of the Act relating to such sales. [fol. 639] It is imperative for the proper enforcement of the Income and Franchise Tax Act that the present regulation pertaining to sales corporations be amended. Since the District of Columbia Tax Court refuses to apply the present regulation, the Finance Office has been placed in an untenable position in its dealings with corporate taxpayers. It is believed that the proposed three-factor formula comes as near to complete equity as is possible in this complex area of taxation.

It is recommended that the attached proposed amendment to Section 10.2-(c) of the Income and Franchise Tax Regulations be referred to the Corporation Counsel for technical legal review with instructions to incorporate this proposed amendment to Section 10.2-(c) of the Regulations with the proposed amendment to Section 10.2-(c) which was forwarded to the Commissioners on February 7, 1961. It is further recommended that, after review by the Corporation Counsel, a public hearing be held on the proposed amendments after which, with such changes as may appear

necessary, the attached proposed amendment be approved by the Commissioners to become effective January 1, 1962.

Finance Officer

Approval recommended:

Director of General Administration

[fol. 640]

APPENDIX "B" TO OPINION

PROPOSED AMENDMENT TO SECTION 10.2-(c)(1) OF THE REGULATIONS PERTAINING TO THE DISTRICT OF COLUMBIA INCOME AND FRANCHISE TAX ACT OF 1947, AS AMENDED

(8) Where income for any taxable year is derived from the manufacture and sale or purchase and sale of tangible personal property, the portion thereof to be apportioned to the District shall be determined by multiplying the total net income from such trade or business by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

(a) The property factor is a fraction, the numerator of which is the average value of the real and tangible personal property owned by, rented to, or used by the taxpayer in the District during the taxable year, and the denominator of which is the average value of the real and tangible personal property owned by, rented to, or used by the taxpayer everywhere: Provided, that neither the numerator nor the denominator of the property factor shall include property, or any portion thereof, the taxpayer's income from which is subject to direct allocation of these regulations, or which is used by the taxpayer in a trade or business, the income from which is allocable or apportionable under another method or formula of these regulations. Where property is used in any activities the income from which is allocable or

apportionable partly under this subsection and partly under another section or subsection of these regulations, the taxpayer may employ, subject to the approval of the Assessor, or the Assessor may require the use of any method which will reflect properly

[fol. 641] the portion of the average value thereof to be used in arriving at the property factor under this subsection.

Property owned by the taxpayer is valued at its original cost to the taxpayer. Property rented to or used by the taxpayer is valued at eight times the net annual rental rate which is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals, provided that such rental and subrental rates are reasonable. The term "net annual rental rate" includes amounts paid or accrued for the use or rental of the property or facilities of another whether paid as rent, reasonable compensation for use or by any other designation, and whether paid pursuant to statutory enactment, lease or rental agreement of any kind, contract, or otherwise. If the Assessor shall determine that any net annual rental rate or subrental rate is unreasonable, or if no rate is charged, he may determine and apply such rate as will reasonably reflect the average value of the property rented to or used by the taxpayer.

The average value of property shall be determined by averaging the values at the beginning and end of the tax period, but monthly or quarterly values of property may be used by the taxpayer, subject to the approval of the Assessor, or the Assessor may require the use of such values if reasonably necessary to reflect properly the average value of property owned by, rented to, or used by the taxpayer during the tax period.

[fol. 642] (b) The payroll factor is a fraction, the numerator of which is the total compensation paid or accrued by the taxpayer in the District during the tax-

able year, and the denominator of which is the total compensation paid or accrued by the taxpayer everywhere during the taxable year. "Compensation" means wages, salaries, commissions, and any other form of remuneration paid or accrued to officers and employees for personal services, and, in the case of unincorporated businesses, compensation also means wages, salaries, commissions, and any other form of remuneration paid or accrued to the individual owners and members for personal services actually rendered without regard to the 20 per centum limitation provided for in Section 3(a)(15) of Title III. Compensation paid or accrued other than in cash shall be valued at its fair market value as of the date of payment or accrual, whichever is earlier. Compensation is paid or accrued in the District if—

(1) the individual's service is performed within the District, or

(2) the individual's service is performed within and without the District, but the service is performed primarily within the District, or

(3) some of the individual's service is performed in the District and (A) the base of operations or, If there is no base of operations, the place from which the service is directed or controlled
[fol. 643] is in the District or (B) the base of operations or the place from which the service is directed or controlled is not in the District or in any state in which some part of the service is performed, but the individual's residence is in the District.

Where compensation is paid or accrued for services the income from which is allocable or apportionable partly under this subsection and partly under another section or subsection of these regulations, the taxpayer may employ, subject to the approval of the Assessor, or the Assessor may require the employment of any method which will reflect properly the

portion thereof to be used in arriving at the payroll factor under this subsection.

(c) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in the District during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year.

Sales of tangible personal property to the United States Government are in the District if the income derived therefrom is not excluded from gross income as provided in Title III, Section 2(b)(13) of the Act. Sales of tangible personal property, including sales to the United States Government, are in the District, regardless of the point of passage of title, f.o.b. point, or other conditions of such sales, if—

(1) the property is delivered or shipped to a purchaser within the District, or

[fol. 644] (2) the property is delivered or shipped to a point outside the District but the ultimate destination of such property is a purchaser within the District, or

(3) the property is delivered or shipped to a purchaser outside the District but such sales result from orders taken or solicited by employees, agents or representatives of the taxpayer located in the District, or placed with or through an office or other place of business of the taxpayer in the District and such sales are not taxed to the taxpayer by the state to which the property is shipped.

March 22, 1961

[fol. 645]

APPENDIX "C" TO OPINION

GOVERNMENT OF THE DISTRICT OF COLUMBIA
EXECUTIVE OFFICES
WASHINGTON, D. C.

March 30, 1961

MEMORANDUM TO THE CORPORATION COUNSEL:

Forwarding, herewith, memorandum, under date of March 22, 1961, addressed to the Commissioners, by the Finance Officer, entitled: "Proposed amendment to the income and Franchise Tax Regulations implementing the District of Columbia Income and Franchise Tax Act of 1947, as amended."

Your attention is invited to the last paragraph of this memorandum, which reads as follows:

"It is recommended that the attached proposed amendment to Section 10.2(c) of the Income and Franchise Tax Regulations be referred to the Corporation Counsel for technical legal review with instructions to incorporate this proposed amendment to Section 10.2(c) of the Regulations with the proposed amendment to Section 10.2(c) which was forwarded to the Commissioners on February 7, 1961. It is further recommended that, after review by the Corporation Counsel, a public hearing be held on the proposed amendments after which, with such changes as may appear necessary, the attached proposed amendment be approved by the Commissioners to become effective January 1, 1962."

The Commissioners, at their Board Meeting on March 28, 1961, approved this recommendation.

Secretary to the Board

/s/ Geoffrey M. Thornett

[fol. 646]

BEFORE THE DISTRICT OF COLUMBIA TAX COURT

Docket No. 1698

DECISION—January 29, 1962

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing on said petition, it is, by the Court this 29th day of January, 1962,

ADJUDGED AND DETERMINED, That a deficiency in franchise tax for the calendar year 1957 in the amount of $171,621.85, and interest thereon in the amount of $22,228.15, or a total of $193,850.00, were erroneously assessed against and collected by the respondent from the petitioner; and that the petitioner is entitled to a refund thereof with interest thereon at the rate of 4 per centum per annum from May 20, 1960, to the date of the payment of the refund.

Jo. V. Morgan, Judge.

[fol. 647]

BEFORE THE DISTRICT OF COLUMBIA TAX COURT

Docket No. 1699

DECISION—January 29, 1962

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing on said petition, it is, by the Court this 29th day of January 1962,

ADJUDGED AND DETERMINED, That a deficiency in franchise tax for the calendar year 1958 in the amount of $115,109.09, and interest in the amount of $8,090.74, or a total of $123,199.83, were erroneously assessed against, and collected by the respondent from the petitioner; and that the petitioner is entitled to a refund thereof with interest thereon at the rate of 4 per centum per annum from May 20, 1960, to the date of the payment of the refund.

Jo. V. Morgan, Judge.

[fol. 648]

BEFORE THE DISTRICT OF COLUMBIA TAX COURT

MOTION TO AMEND FINDINGS OF FACT AND OPINION—
Filed February 5, 1962

Petitioner, General Motors Corporation, respectfully moves this Court to amend the findings of fact and opinion filed January 29, 1962, in the following particulars:

I.

Petitioner moves that finding of fact number 3 be amended by changing the figure "$18,130,000.00" to $6,940,309.50," and by adding the following additional sentence to such finding: "A portion of the income of petitioner derived from sales within the District of Columbia of goods manufactured in those states was taxed by those states, pursuant to the apportionment formulas provided by their laws."

The error in the total amount paid to Michigan resulted apparently from the confusing mass of canceled checks, receipts and other documents which were introduced to evidence tax payment to Michigan. The correct figure, above, may be determined from Exhibits 21a-f, which consists of receipts and a letter showing the application of payments.

With respect to the requested additional sentence, the grounds of this motion are that a finding that taxes were paid to other states becomes meaningful only if such taxes were based in part on the same income taxed in the District. The requested finding is supported by Exhibits 9, 12, 15, 18 and 19 (tax returns) and by the statutes of which the Court [fol. 649] took judicial notice (Tr. 88-89, 93, 98; Ex. 8).

II.

Petitioner moves that the findings of fact be amended by adding the following additional findings:

"5. The segment of petitioner's business that is conducted both within and without the District of Columbia

involves the manufacture of a certain number of automobiles and kindred products wholly without the District and the sale thereof to customers within the District. The net income from this segment of petitioner's business is earned by and is fairly attributable to both its manufacturing and selling activities, and such net income is earned in part by the manufacture outside the District of the articles sold to customers within the District. While such net income is not *realized* until sale, it is *earned* in part by the manufacture of the article sold.

"6. The method used by respondent attributed to the District 100% of the net income derived by petitioner from that segment of its business which consisted of the manufacture and sale of the products which were sold to customers in the District, which percentage is out of all appropriate proportion to the business carried on or engaged in by petitioner within the District.

"7. For 1957, the portion of petitioner's aggregate net income which was fairly attributable to business activities [fol. 650] carried on or engaged in within the District was .15427. thereof. For 1958, such portion was .1625% thereof."

The grounds for this motion are that, while proposed findings 5 and 7 and a portion of proposed finding 6 are fully covered in the opinion of this Court, petitioner believes such matters may properly be regarded as factual and should be found as facts. The Court of Appeals, in *Smoot Sand & Gravel Corp.* v. *District of Columbia,* 261 F. 2d 758, 764-5 (D. C. Cir. 1958), cert. denied, 359 U. S. 968 (1959), treated the question of the activities to which income is "fairly attributable" as a factual matter to be supported by evidence, and hence it is a matter on which findings of fact ought to be made.

The last clause of proposed finding number 6 is a finding which this Court expressly declined to make, on the ground that it was immaterial in the light of the *Smoot* case. (Opinion page 19.) The *Smoot* case does not hold that the arbitrary and unreasonable result of applying the sales factor to the taxpayer was immaterial, but that the taxpayer had "failed to show" that such was the result, and that

"the evidence fails to demonstrate clearly and cogently that the use of either or both factors would produce a more accurate apportionment." (261 F. 2d at 764, 765.) The case turns, not on the immateriality of such evidence, but on the absence thereof. Whether or not this Court has power to determine the constitutionality of the formula, it is [fol. 651] charged with making findings of fact based upon the evidence presented, on the basis of which the Court of Appeals may determine the constitutional issue. That the question dealt with in proposed finding number 6 is factual is clear both from the *Smoot* case and from *Hans Rees' Sons* v. *North Carolina*, 283 U. S. 123 (1931).

III.

Petitioner moves that the second paragraph of the opinion (on page 3 thereof) be amended by changing the figure "$327,049.23" to "$317,049.83," to conform it to the total of the amounts computed on page 26 of the opinion and entered in the decision.

IV.

Petitioner moves that the second sentence of Part VI of the opinion (on page 18 thereof) be amended by changing the portion thereof before the semicolon (which reads, "The petitioner's experts testified that in their opinion no income resulted from the sales in themselves, but solely from manufacture and administrative activities;" to read as follows:

> "The petitioner's experts testified that in their opinion no income resulted from sales in themselves, but solely from petitioner's manufacturing, selling, administrative and other activities;"

and that the statement "Both sets of witnesses were in [fol. 652] error" be modified or eliminated.

The ground for this motion is that the Court appears to have inadvertently omitted an important portion of the position of the petitioner's witnesses, who emphatically stated that *selling activities* contribute, together with other activities, to the production of income. (Tr. 120, 163-64, 168,

285, 289-90, 552.) The Court's disagreement with petitioner's witnesses appears to relate, not to the economic activities which result in the income, but to whether two factors or three are necessary in order properly to attribute such income for tax purposes. It was the expert testimony which established as a *fact* that petitioner's income is derived in part from its manufacturing activities carried on outside the District and filled in the gap which the Court of Appeals found fatally defective in *Smoot*. To characterize it as "in error," without qualification, might be construed to destroy the basis for the additional findings above requested which we consider essential to avoid the evidentiary problems encountered by Smoot.

If the Court accepts the additional findings proposed above, some revision of the balance of Part VI of the opinion, beginning with the last sentence on page 18, is necessary. For the convenience of the Court in considering this request, we attach as an appendix hereto our analysis of the matters covered in Part VI of the opinion in the light of what we understand to be the Court's views.

[fol. 653]

Appendix to Motion to Amend Findings of Fact and Opinion

Petitioner produced four expert witnesses in the fields of economics and accounting, and respondent produced in answer three expert witnesses in economics. Petitioner's fourth expert (Morton) was called in rebuttal. Petitioner's experts (Paton, Studenski, Powell and Morton) testified that in their opinion no income resulted from sales in themselves but solely from business activities including manufacturing, administrative, selling and other activities; that the relative contributions of the various elements are measured by their costs; and that, limiting their testimony to economic and accounting considerations, the proper practicable factors to be used in a formula for the apportionment of net income of a multi-state manufacturing corporation are those of property and payroll. Pet. Br. pp. 37-48; Tr. 120, 129, 158-60, 163-69, 173, 178-79,

284-85, 287-88, 301-02, 318, 323-24, 535-36, 554-55, 566-76, 587-88. While respondent's experts started in each instance with the diametrically opposed opinion that all income is attributable to sales as such and that hence geographically all income should be attributed to the situs of the customer without regard to the activity of the taxpayer at that or any other point, their explanations thereof disproved the opinion.

It became clear that one of respondent's witnesses [fol. 654] (Bailey) was talking about the *realization* of income, not its *earning*. Pet. Br. pp. 49-51; Tr. 379-81, 401-02. Of course, as observed in the *Bass, Ratcliff and Gretton, Ltd.* case, the income is not realized or received until the sale, but that does not mean that it is not earned by the numerous activities which culminate in the sale. One witness (Watson) on cross-examination made it clear that what he meant was that the sales fraction determines (in the absence of separate accounting) the portion of petitioner's total net income that arises from its manufacture and sale of the portion of production sold to customers in the District, and that to attribute to the District 100% of the portion of income so found does not meet the statutory requirement that it be deemed to arise from sources within and without the District. Pet. Br. pp. 52-56; Tr. 443-48, 456-68, 482-83. See also Pet. Br. pp. 60-61.

The third witness (Nathan), rather astonishingly in the light of his experience in the development of statistics of national income (which attribute income to production of goods and services and measure them by costs precisely as did petitioner's experts), thought that all sorts of imponderables entered into income that could not be measured or reasonably approximated, and that, hence, income might as well be assigned entirely to the location of the market, especially in the case of the District of Columbia in which the largest employer is not a taxpayer and which has relatively little taxable industry of its own. He too recognized [fol. 655] that his suggestion would not comply with the statutory mandate that income from business within and without the District be apportioned. Pet. Br. 56-60; Tr. 492-96, 504-6, 509, 514, 521-24.

One of petitioner's witnesses (Morton) testified, although agreeing with the others that sales in themselves have nothing to do with the production of income, that certain special costs, such as advertising, might reasonably be attributed to the situs of the customer as being the place where they took effect so that a destination sales factor would be appropriate to assign that proportion of the income which such costs bore to all costs. Pet. Br. pp. 44-45; Tr. 573-74, 576-77, 621.

The testimony of the experts for both sides, together with the stipulations, established that the great majority of that amount of petitioner's income derived from the manufacture and sale of products sold to District customers arose from activities carried on by petitioner outside the District, and that, hence, attributing 100% of such income to the District was grossly excessive and disproportionate to the amount of income actually derived from business carried on or engaged in within the District. Pet. Br. pp. 46-48; Tr. 158-69, 246-47, 294-95, 533-36, 539-41.

* * * * * * *

[fol. 656]

BEFORE THE DISTRICT OF COLUMBIA TAX COURT

OPPOSITION OF RESPONDENT TO PETITIONER'S MOTION TO AMEND FINDINGS OF FACT AND OPINION—Filed February 14, 1962

Petitioner moves this Court to amend finding of fact number 3. Respondent does not oppose the correction of the amount set forth in that finding, if it is in error. However, respondent does not admit that the change in amount, as sought by petitioner, is correct, since it depends upon a proper computation by this Court based upon the various documents contained in petitioner's exhibits 21a-f.

Petitioner has also requested that an additional sentence be added to the Court's finding of fact number 3 to read as follows:

"A portion of the income of petitioner derived from sales within the District of Columbia of goods manu-

factured in those states was taxed by those states, pursuant to the apportionment formulas provided by their laws."

Respondent objects to the addition of this sentence since it is not supported by exhibits 9, 12, 15, 18 and 19 (tax returns), or by the statutes of which the Court took judicial notice (Tr. 88-89, 93, 98; Exhibit A). These exhibits prove only that certain taxes were paid to the states identified in these exhibits, and there is no proof that the taxes were properly computed, were required to be paid, or were based in part on the same income as was taxed by the District.

Petitioner moves the Court to add additional findings of fact to be numbered 5, 6 and 7 and to read as set forth in [fol. 657] its motion. With the exception of the first sentence of proposed finding number 5, which is fully covered in the findings of fact of the Court, the remainder of the proposed findings is directed not to facts, but to conclusions of law. Intertwined with the conclusions of law are the opinions given by the economists testifying for the petitioner. The decision of this Court was based upon its findings of fact, which are fairly stated, and its opinion. The opinion contains this Court's conclusions of law in respect of the matters presented to it. Petitioner desires through proposed findings of fact 5, 6, and 7 to incorporate, in part, this Court's opinion into its findings of fact. Moreover, as an example, proposed finding number 7 depends entirely upon the opinion of this Court, for, without it, the finding would be impossible. The same is true of proposed finding number 6 and the second and third sentence of proposed finding number 5.

Respondent agrees to the change suggested in part III of petitioner's motion.

Respondent is opposed to the proposed modification of the Court's opinion as contained in part IV of petitioner's motion. The modification reads as follows:

"The petitioner's experts testified that in their opinion no income resulted from sales in themselves, but solely from petitioner's manufacturing, selling, administrative and other activities;"

The statement as sought by petitioner does not properly reflect the testimony of petitioner's expert witnesses. Their [fol. 658] testimony rated the selling activity of petitioner as just another of petitioner's costs which would be included in the total cost of manufacturing. The sentence in the Court's opinion which petitioner seeks to modify is, contrary to the modification, a correct sentence.

Petitioner urges the Court in part IV of its motion to strike the statement in its opinion that "Both sets of witnesses were in error." This statement obviously represents a conclusion on the part of the Court. Respondent does not, of course, agree with the Court that the witnesses for the District were in error.

Attached to petitioner's motion is an "Appendix" which petitioner desires the Court to follow in a revision of part VI of its opinion. The Appendix consists of a recitation by petitioner which it says reflects the testimony of the expert witnesses who testified at the trial. It is apparent that petitioner is desirous, first, of having this Court paraphrase the statements of petitioner's witnesses in the manner deemed desirable by petitioner, second, to reject the testimony of the expert witnesses for the District in paraphrasing selected by petitioner, and, third, in so doing, to employ phraseology which does not comport with fact. The Appendix is not based upon this Court's findings of fact, does not correspond with the evidence, and is improper.

As an example of the erroneous statements made in the Appendix, the very first sentence thereof reads:

> [fol. 659] "Petitioner produced four expert witnesses in the fields of economics and accounting, and respondent produced in answer three expert witnesses in economics."

The experts produced by petitioner qualified themselves as economists, not expert accountants. In fact, this Court declined to accept the testimony of respondent's witnesses as accountants.

Respondent does not deem it necessary to repeat here every objectionable statement contained in the appendix.

It is apparent, however, that petitioner has recognized the fact that the expert testimony given by the economists who appeared for the District in this case established as a matter of economic principle, that the District's formula for apportionment of income was fair and reasonable, was based upon sound principles, and produced a proper result. Petitioner also recognizes that each of its expert economists stated, in essence, that, as a matter of economic principle, only a formula based upon factors of property and payroll (capital and labor), was acceptable, although they saw no harm in adding sales.

In part VI of the opinion of the Court, reference is made to the expert testimony adduced at trial. In view of the statements by the Court that it has concluded that both sets of witnesses were in error (a conclusion which respondent does not agree in connection with the testimony of the expert economists for the District) and because of the statement by the Court that, as a result of its rejection [fol. 660] of all of the expert testimony, it would not make findings of fact on the subject matter of the experts' testimony, respondent has not urged this Court to make specific findings of fact in this area. However, in the event that this Court concludes to make findings of fact as to the substance of the expert witnesses' testimony, respondent requests this Court to make such findings not only in connection with the testimony on behalf of petitioner, but equally and completely upon the testimony of the expert witnesses for the District. In the event this Court determines to make such findings, respondent desires an opportunity equally with petitioner to submit to the Court such findings as, in its view, are necessary and proper, or, in the absence of such opportunity, to file such motions in respect of any findings made by the Court as respondent deems desirable.

* * * * * * *

[fol. 661]

BEFORE THE DISTRICT OF COLUMBIA TAX COURT

Docket Nos. 1698 & 1699

[Title omitted]

MOTION TO VACATE DECISION IN FAVOR OF PETITIONER, AND FOR ENTRY OF DECISION IN FAVOR OF RESPONDENT—Filed February 13, 1962

Pursuant to Rule 12(f) of the Rules of Procedure before the District of Columbia Tax Court, respondent, District of Columbia, moves the Court, on the ground that its decision of January 29, 1962, does not accord with the law and evidence applicable to this proceeding, to vacate said decision and to enter a decision affirming in full the assessments of franchise tax against petitioner for the years 1957 and 1958. The bases for this motion are as follows:

1. In its opinion of January 29, 1962, this Court rejected in their entirety not only the Commissioners' regulations of August 6, 1953, which had been approved by the Court of Appeals in *District of Columbia* v. *Gallant, Incorporated*, —— U. S. App. D. C. ——, 290 F. 2d 745, and other cases,[1] but also the Commissioners' amendatory regu- [fol. 662] lations of July 14, 1961, promulgated by them in accordance with the opinion of the Court of Appeals in *Gallant*.

As a consequence of its action upon the Commissioners' regulations, this Court has adopted and applied in this case a "formula" devised by it and predicated upon factors of property, payroll, and sales, a "formula" which neither

[1] Other cases of equal applicability and import are, for example, *Smoot Sand and Gravel Corporation* v. *District of Columbia*, 104 U. S. App. D. C. 292, 261 F. 2d 758; *District of Columbia* v. *Evening Star Newspaper Co.*, 106 U. S. App. D. C. 360, 273 F. 2d 95; and *District of Columbia* v. *Radio Corporation of America*, 98 U. S. App. D. C. 119, 232 F. 2d 376, cert. den. 352 U. S. 845. The Tax Court's opinion in *Thompson Dairy* v. *District of Columbia*, DCTC Nos. 1731 and 1733, of itself requires the application of a single factor sales formula in the instant case.

comports with the Commissioners' regulations, nor with the opinions of the Court of Appeals upon these regulations.

The Court relies upon its Memorandum of September 21, 1961, issued following remand to this Court of *Gallant*. The "formula" promulgated for application to General Motors Corporation is one which the Court, in that Memorandum, said "would be more suitable and fairer to the District." Therein, also, after setting forth the single factor sales formula which it applied to *Gallant*, this Court said of its "formula":

> "This Court does not mean that it is the best that can be adopted, because it believes a formula with factors of property, payroll, and sales would be more suitable and fairer to the District, in that it would reflect the net income that could be said to result from the use by the petitioner of property and administrative activities in the District."

[fol. 663] The application in this case of a "formula" with factors of property, payroll, and sales which this Court said in *Gallant* is "more suitable and fairer to the District" has resulted in a decision requiring the District to refund to General Motors Corporation franchise taxes for the tax years 1957 and 1958 and interest amounting in total to $317,049.23, a refund which would not be required if the Commissioners' regulations were applied.

The decision of the Court based upon a "formula" of property, payroll and sales is unauthorized, is contrary to the Commissioners' regulations and to law, and produces an improper result. The Decision ought to be vacated.

2. Attached to the opinion of the Tax Court as Appendices A, B, and C are, first, a copy of a memorandum dated March 22, 1961, from the Finance Officer, D. C., to the Commissioners; second, a copy of attachments to the Finance Officer's memorandum; and third, a copy of a memorandum dated March 30, 1961, to the Corporation Counsel from the Secretary to the Board of Commissioners.

The appendices to the Court's opinion were not at any time before this Court at any stage of its proceedings, nor

are they a part of the record in this case. They were not furnished to the Court by counsel for the District nor, as far as counsel for the District are aware, were they furnished to the Court by counsel for General Motors Corporation. [fol. 664] In view of the foregoing, and because of the obvious significance which the Court has attached to said Appendices and because, also, of the prejudice to the District which has resulted therefrom, there is attached hereto as Exhibit 1 to this motion, which exhibit is made a part hereof, a copy of a memorandum to the Corporation Counsel dated February 8, 1962, from the President, Board of Commissioners, D. C. This memorandum, which refers to the memorandum of the Finance Officer to the Commissioners under date of March 22, 1961, correctly sets forth the action of the Commissioners upon that memorandum, and states the Commissioner's position that the existing regulations are valid, lawful, and in full force and effect. In view of the influence that Appendices A, B, and C had upon the opinion and judgment of this Court, the decision ought to be vacated.

EXHIBIT ONE TO MOTION TO VACATE DECISION IN FAVOR OF PETITIONER, ETC.

TO THE CORPORATION COUNSEL:

At the Executive Session of the Board Meeting on February 8, 1962, you called to the attention of the Commissioners the decision of the District of Columbia Tax Court of January 29, 1962, in *General Motors Corporation* v. *District of Columbia,* D. C. T. C. Nos. 1698 and 1699, in which the Tax Court devised and applied a three-factor formula for apportioning the income of General Motors for purposes of the District Corporation Franchise Tax. In the decision, Judge Morgan of the Tax Court referred to a [fol. 665] memorandum by the Finance Officer to the Commissioners under date of March 22, 1961, submitting to the Commissioners for consideration a proposal for adoption of a three-factor formula.

While the opinion does not state that the proposal of the Finance Officer was approved by the Commissioners, such

an inference may be drawn therefrom. Actually, as you know, the Commissioners have not approved a three-factor formula. Neither have they made any determination that the present regulation is inequitable or unworkable. All that they have approved is a reference of the proposal to your office for study and report, after which they expect to hold a public hearing before any conclusion is reached in the matter. The regulations of the Commissioners embodying the single factor sales principle, which principle has heretofore been approved by the Court of Appeals, continue to be valid, lawful and in full force and effect.

This is accordingly your formal directive to proceed with such action as you deem proper, in the *General Motors* case, including appeal to the United States Court of Appeals. If you believe it advisable, you are authorized to bring this directive to the attention of the Tax Court or the Court of Appeals, or both.

[fol. 666]

BEFORE THE DISTRICT OF COLUMBIA TAX COURT

MOTION TO STRIKE PORTIONS OF THE COURT'S OPINION AND APPENDICES A, B, AND C TO THE OPINION—
Filed February 13, 1962

Respondent, District of Columbia, pursuant to Rule 12(f) of the Rules of Procedure before the District of Columbia Tax Court, moves the Court to strike the hereinafter quoted portions of its opinion and to strike also Appendices A, B, and C attached to that opinion.

The grounds for this motion are as follows:

On January 29, 1962, this Court filed memorandum Opinion No. 992 which contained therein certain material based on evidence that was not before this Court at the hearings on these cases. The Court made the following statement at page 9 of its opinion:

> "* * * A formula with the factors of property, payroll and sales would have saved that revenue, which no doubt, is why the Finance Officer of the District has repeatedly requested and urged the Commissioners

to adopt the three factor formula for consistent use, that is to say, for the taxation of both resident and non-resident taxpayers.[11]

[11] Formal submission of the three factor formula to the Commissioners and action thereon will appear from the Appendices A, B, and C to this opinion."

At page 23 of its opinion the Court made the following statement:

> "The foregoing formula is, incidentally, substantially similar to the formula provided for multistate businesses in the Uniform Division of Income for Tax [fol. 667] Purposes Act, and to that recommended by the Finance Officer to the Commissioners in a memorandum dated March 22, 1961, and tentatively approved by the Commissioners on March 30, 1961 (See Appendices "A", "B" and "C" to this opinion). The formula, however, is adopted, because, in the opinion of the Court, it is intrinsically the best suited under the facts and in view of the nature of the trade or business involved herein."

Nowhere in the record is there any evidence to support either the above-quoted portions of the opinion of the Court, or to support the inclusion of Appendices A, B, and C which the Court made a part of its opinion. There can be no question but that this material is outside the record. It should not have been included in the Court's opinion, nor should have formed any basis for it. All of it should be stricken.

BEFORE THE DISTRICT OF COLUMBIA TAX COURT

MEMORANDUM IN OPPOSITION TO RESPONDENT'S MOTION TO STRIKE PORTIONS OF THE COURT'S OPINION AND APPENDICES A, B AND C TO THE OPINION—Filed February 23, 1962

Respondent, in its motion to strike, appears to find some impropriety in this Court's referring in its opinion to cer-

tain memoranda in which the Finance Officer recommended to the Commissioners that they adopt a three-factor formula for apportionment, and the Commissioners referred the matter to the Corporation Counsel for study and report. [fol. 668] The stated ground for the objection is that such material is outside the record.

There is, however, a sound distinction between those matters on which fact findings are based and those which form the basis for drawing legal conclusions or fashioning remedies. Fact findings relating to the particular controversy between the parties must, of course, be based on the evidence of record, with the narrow exceptions permitted by the doctrine of judicial notice. But, as Mr. Justice Holmes clearly stated, "the Court may ascertain as it sees fit any fact that is merely a ground for laying down a rule of law." *Chastleton Corp.* v. *Sinclair,* 264 U. S. 543, 548 (1924).

Examples are legion in which the courts have gone beyond the record (and not merely for the indisputable facts which are commonly subject to judicial notice) in support of a legal conclusion. A well-known example in this jurisdiction is *Durham* v. *United States,* 214 F. 2d 862, 870 (D. C. Cir. 1954), in which the Court declared that "Medico-legal writers in large numbers * * * present convincing evidence that the right-and-wrong test is 'based on an entirely obsolete and misleading conception of the nature of insanity.'" The Court cited and quoted from numerous articles, books, and reports as the basis for its legal conclusion that one who knows the difference between right and wrong and is not the victim of irresistible impulse can [fol. 669] nevertheless be irresponsible because of insanity. The United States Supreme Court has many times drawn upon materials outside the record for facts in support of its legal conclusions. For example, in *Virginia Ry.* v. *System Federation No. 40,* 300 U. S. 515, 545-46 (1937), it referred for such purpose to testimony in another case, between different parties; in *Parker* v. *Brown,* 317 U. S. 341, 364 (1943), it referred to economic studies made under university auspices; and in *Brown* v. *Board of Education,* 347 U. S. 483, 494 (1954), to sociological and psychological writings.

The Court of Appeals for the District of Columbia, in *Potts* v. *Coe*, 145 F. 2d 27 (D. C. App. 1944), was confronted with a motion comparable to the present motion to strike. In its original opinion, 140 F. 2d 470, the Court had referred to many sources outside the record for information supporting its legal conclusion concerning the patentability of the products of industrial research laboratories. The plaintiff filed a motion to vacate the decision and to withdraw the opinion, on the ground that it had gone beyond the record and had rested on testimony at hearings in investigations authorized by Congress. The Court held the argument "not worthy of serious consideration," and stated that "Facts brought out by such investigations are particularly important in construing the patent law * * *." (145 F. 2d at 31.)

A further principle is pertinent here. So far as this [fol. 670] Court may have given any weight to the documents in question, it was in fashioning the remedy—i.e., in devising the apportionment formula to be applied. The United States Supreme Court has stated, in *National Labor Relations Board* v. *Seven-Up Bottling Co. of Miami, Inc.*, 344 U. S. 344, 348 (1953):

> "It is urged, however, that no evidence in this record supports this back pay order; that the Board's formula and the reasons it assigned for adopting it do not rest on data which the Board has derived in the course of the proceedings before us. But in devising a remedy the Board is not confined to the record of a particular proceeding."

Judge Learned Hand, in *United States* v. *Aluminum Co. of America*, 148 F. 2d 416, 445-46 (2d Cir. 1945), applied the same principle to proceedings of a judicial nature, when he said:

> "For these reasons we refuse to take 'notice' of facts relevant to the correctness of the findings; but we do take 'notice' of those relevant to remedies."

The principles applicable to judicial reliance on facts outside the record, in formulating conclusions of law and

devising remedies, are ably discussed in Davis, "Judicial Notice," 55 Columbia Law Review 945, 952-66 (November 1955); and in Judge Wyzanski's lecture on "A Trial Judge's Freedom and Responsibility," 65 Harvard Law Review 1281, 1295-96 (June 1952). A pertinent discussion by Judge Currie of the Wisconsin Supreme Court, entitled "Appellate Courts' Use of Facts Outside the Record by Resort to Judicial Notice and Independent Investigation", 1960 Wisconsin Law Review 38 (January 1960), is of par- [fol. 671] ticular interest for its treatment of judicial notice of files and correspondence in State offices, which had not been introduced in evidence (pp. 43-45).

The foregoing principles establish that this Court's reference to materials outside the record would have been entirely proper even if such materials had been essential to the Court's conclusions. Since the Court carefully disclaimed reliance thereon and reached its conclusion on independent grounds, it is *a fortiori* true that respondent has nothing of which to complain. As the Court of Appeals said in *Potts* v. *Coe, supra* (145 F. 2d at 31), "We suspect that the underlying reason for [respondent's] objection is not that it is based on judicial notice * * *. It is rather that it lays down a principle of law which is not acceptable to [respondent]."

Respondent's motion to strike should be denied.

BEFORE THE DISTRICT OF COLUMBIA TAX COURT

MEMORANDUM IN OPPOSITION TO RESPONDENT'S MOTION TO VACATE DECISION IN FAVOR OF PETITIONER, AND FOR ENTRY OF DECISION IN FAVOR OF RESPONDENT—Filed February 23, 1962

The first point in respondent's motion to vacate is simply a reargument of points already fully briefed (Pet. Br. pp. 76-77, 100-105) and considered by this Court in reaching its [fol. 672] decision. This Court has pointed out that, while the *Gallant* decision held the regulation based on a single factor of sales to be valid in that case, there was not there involved a business in which goods were manufactured

without and sold within the District, as in this case. The *Gallant* decision, as this Court observed, directed the Tax Court to determine the formula "best suited" to the case before it, and this Court has done so herein. The reference in the *Gallant* decision to the promulgation of a "valid and pertinent" regulation by the Commissioners does not authorize giving such regulation retroactive effect, nor does it permit adoption of a regulation inconsistent with the statute. Petitioner sees no need to add anything at this time to the reasoning of this Court on those points, as found particularly at pages 9, 19-21 and 23-24 of its opinion.

Respondent's second point makes specific objection to the Appendices to the Court's opinion, "because of the obvious significance which the Court has attached to said Appendices and because, also, of the prejudice to the District which has resulted therefrom," for which reason respondent urges that the opinion and judgment be vacated. This Court, however, made it very clear that it reached its conclusion on fully sufficient grounds independent of the material in such Appendices. The recommendations of the Finance Officer were referred to merely as showing that the administrators had reached a conclusion in accord with that which the Court had independently arrived at. The [fol. 673] opinion does not, as respondent's motion implies, evidence that the Court was under any misapprehension concerning the finality or authoritative weight of the recommendations.

Accordingly, the decision should not be vacated.

BEFORE THE DISTRICT OF COLUMBIA TAX COURT

MEMORANDUM—Filed February 27, 1962

The petitioner has filed herein a motion to amend findings of fact and opinion. The respondent has filed a motion to strike portions of the Court's opinion and Appendices A, B and C to the opinion, and a motion to vacate decision in favor of petitioner, and for entry of decision in favor of respondent. In addition the Court is of the opinion that it should make certain additions, changes and deletions.

The statement is to serve as the Court's own motion, which will be reflected in the order that will be entered pursuant to this memorandum.

In respect of the portion of the petitioner's motion numbered "I", the Court believes that the motion to the extent there indicated should be granted. There can be no dispute as to the amount of money which should have been stated. The statement that a portion of the income from the sales here involved was taxed by other states under formulas provided by their laws is supported by documentary evidence herein.

[fol. 674] The Court will add findings of fact 5 and 6, but not verbatim as asked in portion "II" of petitioner's motion, but as the Court believes they should be stated and as should have been made in the original findings of fact. The motion as far as the proposed finding 7 is concerned will be denied.

As asked in portion "III" of the petitioner's motion, the figures "$327,049.23" will be changed to "$317,049.83".

In respect of the portion "IV" of the motion dealing with expert testimony the Court will strike out the entire portion of its opinion under the heading "VI, *Expert Testimony*".

The Court on its own motion will add to the recital of constitutional questions in that portion of its opinion under the heading "I, *Constitutional Questions*", the question as to the violation of the constitution by reason of the imposition of a tax out of all reasonable proportion to the business engaged in by the petitioner within the District.

The Court will deny both motions of the respondent. The questions raised by the motion to vacate, etc. with the exception of that relating to Appendices A, B, C, to the opinion, have been dealt with by the Court in its opinion. The Court will not disturb those rulings. In respect of the Court's reference to Appendices A, B and C to the opinion, it is apparent that counsel for the respondent did not understand the purpose of that reference. The Court used the [fol. 675] word "intrinsically" advisedly and meaningly in the sentence related to the formula set up in the appendices and reading as follows:

"The formula, however, is adopted, because in the opinion of the Court, it is intrinsically the best suited under the facts and in view of the nature of the trade or business involved herein."

The Court's ruling was, or should have been clear to everyone that the formula selected was inherently, that is to say, in itself without any extraneous consideration, the best suited to apportion the net income of the petitioner in conformity with or obedience to the plain mandate of the law.

The Court was not influenced by the uniform formula or by that recommended by the Finance Officer, or by anything other than the mandate of the taxing statute, in ruling that the net income from the trade or business involved herein must be deemed to be from sources both within and without the District, and apportioned accordingly; that the one factor formula of sales did not meet the plain and unambiguous requirement of statute; and that the best suited formula was one having factors of property, payroll and sales. Reference was made to Appendices A, B and C for the following purpose. No formula can accurately apportion net income in circumstances present in this case. At best it can only be an approximation. Taxation, as has often been said, is not an exact science. While the three factor formula is generally recognized as appropriate under circumtances like those herein, there are several schools of [fol. 676] thought in relation to the content and delineation of the factors. For instance, some administrators and experts contend that the factor of property should represent its original cost, while others believe it should represent the present actual value. Some believe rented property should be included, while others that it should be excluded. As to payroll, there is one school which holds that the place wherein the compensation is paid, while others claim that the place where the services are performd is the locale. There is even more disagreement on sales. Among others, is whether the situs should be determined by "origin" or by "destination". These and other questions are resolved in the uniform formula which was adopted by the National Conference of Commissioners on Uniform State Laws and

the American Bar Association after several years of intensive study and consideration; and in the similar formula submitted to the Commissioners by the Finance Officer. Reference was made to the formulas to show that the definitions or content of the factors in formula adopted by the Court was reasonable and to some, if not a large extent accepted as such. The Court believes that its reference to the aforementioned formulas was appropriate. *Chastleton Corp.* v. *Sinclair,* 264 U. S. 543, 548, —— L. Ed. ——, —— S. Ct. ——; *Brown* v. *Board of Education* (Footnote 11), 347 U. S. 483, 494, 98 L. Ed. 873, 881, 74 S. Ct. 686; *Potts* v. *Coe,* 79 U. S. App. D. C. 223, 227, 145 F. 2d 27, 31.

[fol. 677] Whether the formula submitted by the Finance Officer was or was not approved by the Commissioners is immaterial. The Court did not rely upon such approval. It might, however, in passing, be observed, that the statement in the opinion that the formula was "*tentatively* approved by the Commissioners" is supported by that portion of the Secretary's memorandum to the Corporation Counsel (Appendix "C") reading as follows:

> " 'It is further recommended that, after review by the Corporation Counsel, a public hearing be held on the proposed amendments after which, with such changes as may appear necessary, the attached proposed amendment be approved by the Commissioners to become effective January 1, 1962.'
>
> "The Commissioners, at their Board Meeting on March 28, 1961 approved this recommendation."

In the event either or both of the parties shall decide to seek review of the decision of the Court, the thirty day period in which a petition for review must be filed begins to run from the date of the order entered this day in accordance with this memorandum. See *Gager* v. *"Bob Seidel", Seidels Restaurant, et al.,* —— U. S. App. D. C. ——, —— F. 2d ——, decided February 20, 1962.

An order will be entered in conformity with this memorandum.

Jo V. Morgan, Judge.

[fol. 678]

BEFORE THE DISTRICT OF COLUMBIA TAX COURT

ORDER AMENDING FINDINGS OF FACT AND OPINION AND DENYING MOTION OF PETITIONER, IN PART, AND MOTIONS OF RESPONDENTS—Filed February 27, 1962

Upon consideration of the motion of the petitioner to amend findings of fact and opinion, the motions of the respondent to strike portions of the Court's opinion and Appendices A, B and C to the opinion and to vacate decision in favor of petitioner, and for entry of decision in favor of respondent, and upon the Court's own motion, it is by the Court this 27th day of February, 1962.

Ordered that the findings of fact are hereby amended to the extent following:

Finding No. 3

(1) By inserting after the figure "3" the symbol and letter "(a)".

(2) By striking out the figures "$18,130,000.00" and inserting in lieu thereof the figures $6,940,309.50".

(3) By adding the sub-finding following:

"(b) A portion of the net income of petitioner derived from the segment of the petitioner's business consisting of the manufacture of products without, and sale within the District of Columbia was taxed by the [fol. 679] above mentioned states, pursuant to apportionment formulas (with factors of property, payroll and sales), as provided by their laws.

Finding No. 5

By adding to the findings of fact the following:

"5. The segment of petitioner's business which was conducted both within and without the District of Columbia consisted of the manufacture of a certain number of automobiles and kindred products without the District and the sale thereof to customers within the District. The net in-

come from this segment of petitioner's business was earned by a series of transactions beginning with the manufacture of products in several states and ending with the sale to customers in the District. While the net income was not realized until sale, it was earned in part by manufacture of the products sold, including, in addition to actual manufacture, procurement of material, financing, use of property and administration."

Finding No. 6

By adding to the findings of fact the following:

"6. The method used by the assessing authority of the District attributed to the District 100 per centum of the net income derived by the petitioner from that segment of its business which consisted of the manufacture without, and sale of the products within the District. The percentage thus determined was out of all reasonable proportion to the [fol. 680] trade or business carried on or engaged in by petitioner within the District."

And It Is Further Ordered that the Opinion of the Court is hereby amended to the extent following:

Introduction

By striking out the figures "$327,049.23" in the second paragraph of the introduction, and inserting in lieu thereof the figures "$317,049.83".

I

Constitutional Questions

(1) By striking out the word "two" in the first line of the portion of the opinion with above heading, and inserting in lieu thereof the word "three".

(2) By striking out the word "and" between the word "jurisdiction" and the symbol and letter "(b)".

(3) By adding after the word "discriminatory" a comma and the following: "and (c) the attributing to the District of Columbia 100 per centum of the net income of the peti-

tioner derived from that segment of its business, which consisted of the manufacture of products without, and sale thereof within the District, resulted in a tax out of all reasonable proportion to its business carried on or engaged in within the District".

VI

Expert Testimony

[fol. 681] By striking out the entire portion of the opinion under the heading "VI, Expert Testimony".

Renumbering of Headings

The heading of all portions of the opinion after that numbered "VI" are renumbered as follows:

VI, *The Gallant Case*

VII, *The Best Suited Formula*

VIII, *Computation of Taxes and Interest Due.*

IX, *Computation of Refund*

X, *Conclusion*

And It Is Further Ordered that the motion of the petitioner to amend findings of fact and opinion, to the extent not herein granted, be and the same is hereby denied.

And It Is Further Ordered that the motions of the respondent to strike portions of the Court's opinion and Appendices A, B and C to the opinion and to vacate decision in favor of petitioner, and for entry of decision in favor of respondent be and the same are hereby denied.

Jo V. Morgan, Judge.

[fol. 699] [File endorsement omitted]

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 17,017 and 17,018

DISTRICT OF COLUMBIA, Petitioner,

v.

GENERAL MOTORS CORPORATION, Respondent.

Petitions for Review of Decisions of the District of Columbia Tax Court

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On Rehearing en banc

OPINION—Decided February 13, 1964

Mr. Henry E. Wixon, Assistant Corporation Counsel for the District of Columbia, with whom *Messrs. Chester H. Gray,* Corporation Counsel, *Milton D. Korman,* Principal Assistant Corporation Counsel, and *Robert E. McCally,* Assistant Corporation Counsel, were on the brief, for petitioner.

Mr. Donald K. Barnes, of the bar of the Supreme Court of Michigan, *pro hac vice,* by special leave of court, with whom *Messrs. Seymour S. Mintz* and *William T. Plumb, Jr.,* were on the brief, for respondent. *Mr. Frank F. Roberson* also entered an appearance for respondent.

Before: BAZELON, Chief Judge, WILBUR K. MILLER, FAHY, WASHINGTON, DANAHER, BASTIAN, BURGER, WRIGHT and McGOWAN, Circuit Judges sitting *en banc.*

[fol. 700] McGOWAN, *Circuit Judge,* with whom *Chief Judge* BAZELON and Circuit Judges FAHY, WASHINGTON and WRIGHT join: These petitions for review from the District of Columbia Tax Court involve the propriety of

assessments under the District's Income and Franchise Tax Act against General Motors Corporation for the years 1957 and 1958. The tax is levied on the net income of General Motors for the privilege of carrying on business within the District; and, as such, is similar to taxes levied by many of the States. The question before this court concerns the legally permissible formula for determining that portion of the net income of a unitary multi-state business which is properly taxable by the District of Columbia. The Tax Court ruled that the District's single-factor formula of apportionment was not permitted by the statute; and, on its own initiative, substituted a three-factor formula. A division of this court, one judge dissenting, affirmed the Tax Court. Because of the importance of the problem to the administration of local taxes, we granted the District's petition for rehearing *en banc*. We now decide that the decisions of the Tax Court must be reversed.

I

The District of Columbia Code imposes a "franchise tax upon every corporation . . . for the privilege of carrying on or engaging in any trade or business within the District and of receiving such other income as is derived from sources within the District," to be measured by "that portion of the net income of the corporation . . . as is fairly attributable" to that business.[1] Where the business "is

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[1] D. C. Code § 47-1580:

"It is the purpose of this subchapter to impose (1) an income tax upon the entire net income of every resident and every resident estate and trust, and (2) a franchise tax upon every corporation and unincorporated business for the privilege of carrying on or engaging in any trade or business within the District and of receiving such other income as is derived from sources within the District: *Provided, however,* That, in the case of any corporation, the amount received as dividends from a corporation which is subject to taxation under this subchapter, and, in the case of a corporation not engaged in carrying on any trade or business within the District, interest received by it from a corporation which is subject to taxation under this subchapter shall not be considered as income from sources within the District for the purposes of this subchapter. The measure of the franchise

[fol. 701] carried on or engaged in both within and without the District, the net income derived therefrom shall . . . be deemed to be income from sources within and without the District," and the portion subject to tax shall be determined by regulations prescribed by the District Commissioners.[2] [fol. 702] Under regulations promulgated August 6, 1953, the formula for determining the tax of a sales corporation engaged in business "partly within and partly without the

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tax shall be that portion of the net income of the corporation and unincorporated business as is fairly attributable to any trade or business carried on or engaged in within the District and such other net income as is derived from sources within the District; *Provided further,* That income derived from the sale of tangible personal property by a corporation or unincorporated business not carrying on or engaging in trade or business within the District as defined in sections 47-1551 to 47-1551c shall not be considered as income from sources within the District for purposes of this subchapter, with the exception of income from sale to the United States not excluded from gross income as provided in section 47-1557a (b) (13)."

[2] D. C. Code § 47-1580a:

"The entire net income of any corporation or unincorporated business, derived from any trade or business carried on or engaged in wholly within the District shall, for the purposes of this subchapter, be deemed to be from sources within the District, and shall, along with other income from sources within the District, be allocated to the District. If the trade or business of any corporation or unincorporated business is carried on or engaged in both within and without the District, the net income derived therefrom shall, for the purposes of this subchapter, be deemed to be income from sources within and without the District. Where the net income of a corporation or unincorporated business is derived from sources both within and without the District, the portion thereof subject to tax under this subchapter shall be determined under regulation or regulations prescribed by the Commissioners. The Assessor is authorized to employ any formula or formulas provided in any regulation or regulations prescribed by the Commissioners under this subchapter which, in his opinion, should be applied in order to properly determine the net income of any corporation or unincorporated business subject to tax under this subchapter."

The rate of tax is 5% (D.C. Code § 47-1571a) of the corporation's "taxable income," which is defined in D.C. Code § 1571 as "the amount of net income derived from sources within the District within the meaning of sections 47-1580 to 47-1580b."

District" is based on a sales factor. The portion taxed by the District is the percentage of the corporation's total net income (determined under other sections of the District Code not here in direct controversy) that its "District sales made during such taxable year bear to the total sales made everywhere during such taxable year." [3]

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[3] "Section 10.2-(b): 'Allocated' and 'Apportioned' Defined. The word 'allocated' as hereinafter used in reference to income and deductions therefrom means a determination based upon actual figures specifically applicable thereto; and the word 'apportioned' as hereinafter used in reference to net income means a ratable portion determined on a percentage basis. If the entire net income is derived from engaging in a trade or business within the District or from sources within the District, all of such income shall be allocated to the District. If the net income is derived from engaging in a trade or business partly within and partly without the District, or from sources both within and without the District, such income shall be allocated and apportioned in accordance with the specific provisions or formulae prescribed in these Regulations."

"Section 10.2-(c): Income Attributed to the District of Columbia. If the trade or business is carried on or engaged in wholly within the District, the entire net income from trade or business shall be allocated to the District. If the trade or business is carried on partly within and partly without the District, that portion of the net income from trade or business to be apportioned to the District shall be determined as follows:

(1) Income from sales of tangible personal property.

(a) Where income for any taxable year is derived from the manufacture and sale or purchase and sale of tangible personal property, the portion thereof to be apportioned to the District shall be such percentage of the total of such income as the District sales made during such taxable year bear to the total sales made everywhere during such taxable year. Every corporation and unincorporated business which carries on or engages in business in the District within the meaning of the words 'trade or business' as defined in the Act is, unless specifically exempted by some provisions of the Act, subject to tax. For the purpose of this regulation, the phrase 'District sales' shall mean all sales to District customers the income from which is fairly attributable to the trade or business carried on or engaged in within the District, including solicitation in the District by salesmen or other representatives of the taxpayer, that portion of sales to customers outside the District the income from which is fairly attributable to the trade or business carried on in the District, and sales of

[fol. 703] For the taxable years 1957 and 1958, General Motors paid a small tax on the theory that only that portion of its income which was derived from business conducted through a District office of one of its divisions constituted "District sales" which were "fairly attributable" to business done within the District. General Motors contended that other sales to dealers in the District did not constitute "trade or business" within the District. The District refused to accept the returns for either year, [fol. 704] and in 1959 mailed notices of tax deficiencies. The District's theory was that income derived from sales of automobiles, other vehicles, and parts to dealers in the District was income from a "trade or business" carried on "partly within and partly without the District," and hence subject to apportionment for the purpose of determining the tax owed to the District. General Motors duly protested the notices of proposed deficiencies. After a hearing, the District Finance Officer rejected the protests and on February 4, 1960, a formal assessment of taxes due was mailed to the company.

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tangible personal property the income from which is from District sources."

These sections are as numbered in the Regulations of July 24, 1956, which reenacted without change the provisions relevant to this case.

On July 14, 1961, the District promulgated new regulations, in response to this court's decision in *District of Columbia* v. *Gallant Inc.*, 110 U.S.App.D.C. 202, 290 F.2d 745 (1961). The controversy in *Gallant* concerned the definition of "District sales," which was found deficient in the earlier regulations, rather than the propriety of the apportionment formula. As will be seen, only the latter point is at issue here. The apportionment formula remained the same as in the 1953 regulations. In *Gallant*, after a remand to the Tax Court and after the new regulations were promulgated, the case again came before this court. 113 U.S.App.D.C. 92, 305 F.2d 761 (1962). We held that the 1961 regulations could not be applied retroactively to determine the tax liability for 1956, but we expressed "no opinion as to whether the 1961 amendments are valid or whether they may in other cases or circumstances be applied retroactively." Since in this case the issue involved is the same under both the new and old regulations, we have no occasion to reconsider our holding in *Gallant*.

[fol. 705] General Motors paid the assessment under protest, and appealed to the Tax Court. In that court, two primary arguments were urged as to the invalidity of the assessed deficiencies: one, that the numerator of the sales formula was too broad, in that it included sales which were not "District sales"; and, two, that use of the single-factor apportionment formula itself was permitted neither by the District Code nor by the Constitution. General Motors requested that all of the additionally assessed tax be refunded.

The Tax Court reversed the assessment, but not to the extent prayed for by General Motors. That court held the single-factor sales formula unauthorized by the District Code, and, in its place, substituted a three-factor formula of property, payroll and sales, each factor receiving equal weight.[4] The result was a tax substantially less [fol. 706] than the District's assessment, but also substantially in excess of the amount originally paid by the taxpayer.

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[4] Numerous qualified economists testified for General Motors in the Tax Court. The general consensus of their testimony, relating to a unitary business such as the manufacture and sale of personal property, was that the income realized from the sale of a finished product is earned by the business as a whole, *i.e.*, by the combination of labor and capital beginning with the first stage in the manufacturing process, and ending with the final sale. They contended that the single-factor sales formula utilized by the District actually allocates to the jurisdiction where the final sale occurs all of the income which is earned at all stages. The Tax Court agreed. Because all of the products sold in the District were manufactured in other states, it "found" that the income from a sale made in the District was actually earned "partly within and partly without" the District, and that the sales formula did not apportion that income as required by the District Code. The court held that the proper formula was one utilizing a combined ratio of General Motors' property in the District to total property, District payroll to total payroll, and District sales to total sales. The sales figures involved and not now in controversy are as follows:

	1957	*1958*
Total sales	$9,461,855,874.00	$7,853,393,381.00
District sales	37,185,704.00	32,542,519.00
Net Income (to be apportioned)	1,312,092,839.15	653,396,893.13

Only the District has appealed from the decisions of the Tax Court. General Motors has not, by an appeal of its own, pressed its original request to have the entire additional assessment refunded. For purposes of this appeal, it appears to concede the correctness of the figures found by the Tax Court as representing "District sales." The controversy before us, therefore, does not relate to the definition of what sales by General Motors properly may be taken to be "District sales," made in the course of a business activity which is carried on both within and without the District. It relates, rather, to the formula to be used for apportioning to the District that part of General Motors entire net income attributable to its "District sales." The District, of course, contends that the single-factor formula is valid. In addition, the District presents an alternative argument which was not made in the Tax Court, namely, that sales to dealers is "other income . . . derived from sources within the District." General Motors argues, first, that the District Code does not permit a formula based only on the sales factor; and, second, that such a formula, if authorized by the statute and as applied to it, is barred by the due process and commerce clauses of the Constitution. The Tax Court did not reach the constitutional issues.

II

Although not critical to a determination of this appeal in its present posture, some analysis of General Motors' [fol. 707] operations in the District enlarges understanding of the issue we do face. The company's principal business is the manufacture and sale of automobiles, trucks and other vehicles, and parts and accessories. No manufacturing or assembly is conducted within the District, but takes place primarily in Michigan, Delaware, and Maryland as to products sold in the District. Orders from dealers are received and filled, and title passes, outside the District.

In addition to a central management staff located primarily in Detroit, Michigan, General Motors is organized into divisions, which operate substantially independently

of each other. Of the five Car Divisions, four (Pontiac, Buick, Oldsmobile, and Chevrolet) have substantially identical operations throughout the country. Within the District in 1957 and 1958, Pontiac and Buick had four dealers each, Oldsmobile and Chevrolet five each. Subject to certain exceptions immaterial here, these divisions sold their products only to authorized dealers.

Each dealer operated under a "Dealer Selling Agreement" which contained a detailed recitation of the parties' obligations. Besides dealing with price (to the dealer, who was not obligated to resell the product at a particular price) and delivery terms, the agreement required the dealer to maintain a satisfactory place of business. Once the dealer was established in facilities and at a location mutually satisfactory to himself and the division, he agreed not to move to or establish a new or different location, branch sales office, branch service station, or place of business, including any used car lot or location, without the prior written approval of the division. Each dealer agreed to maintain specified standards for capital and net worth. He was required to use a uniform accounting system and submit 90-day sales projections, monthly financial and operating statements, and 10-day reports of sales and inventories; and to permit the company to examine his accounts and records when re- [fol. 708] quested. Each agreement required satisfactory sales performance and service to purchasers, and an adequate staff and inventory of parts and accessories. The dealer was also required to erect certain specified signs necessary to advertise the company's products on a mutually satisfactory basis. Finally, the company could terminate the agreement for failure of the dealer to comply with its terms, and a dealer could terminate with or without cause by giving thirty days' notice.

The company's Motors Holding Division, with an office in the District, provided temporary financial assistance for the establishment, reorganization, or expansion of dealerships. In 1957 and 1958, four of the eighteen dealers in the District were receiving this financial aid. Under the program, the dealer provided at least twenty-five

per cent of the required capital, and Motors Holding provided the remainder, in return for voting control. The dealer was required to buy Motors Holdings' interest under a formula geared to operating results. During the program, he was required to submit financial reports every ten days, and an accounting supervisor and branch manager made periodic inspection visits.

Additional inventory financing was available to established dealers through General Motors Acceptance Corporation, a wholly-owned subsidiary which had an office in the District. When a dealer utilized this financing, security title passed to GMAC at the factory. During 1957 and 1958, the four District Pontiac dealers were financed by GMAC.[5]

For administrative purposes, each of the divisions had subdivided the country into "regions." Each region was further subdivided into "zones." As stipulated by the parties, the activities of the Pontiac Division organiza- [fol. 709] tion are typical. The regional office which served the District was located in New York City. A zone office located in Chevy Chase, Maryland, part of the Washington Metropolitan Area, served the District, most of Virginia and Maryland, and small parts of Pennsylvania and West Virginia.[6] There were 120 Pontiac dealers in the zone in the taxable years here involved. The zone manager and his assistant made periodic visits (approximately once a month) to each dealer in the zone, for the purpose of advising on market opportunities, furthering the sale of promotional literature, and maintaining dealer interest in company items to aid the sale of Pontiac automobiles.

These goals were also furthered by one of four district managers who spent all of his time visiting dealers in the Washington Metropolitan Area (28 dealerships).

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[5] There is no indication in the record of the financing arrangements of the other dealers.

[6] The Oldsmobile and Buick zone offices serving the District were in Silver Spring, Maryland, also a part of the Washington Metropolitan Area.

Once a month each dealer submitted to the district manager a 90-day projection of new car requirements. Actual orders for new cars were usually sent directly to the zone office, although the district manager personally took orders to that office on occasion. The orders were processed at the zone office and forwarded for final approval to an assembly plant, where they were filled for shipment, f.o.b. factory, by common carrier directly to the dealer. The zone office also maintained a warehouse outside the District where a small inventory of new cars was kept, and sold from 50-100 cars a month therefrom. When purchased in this manner, the dealer himself would pick up the car from the warehouse.

Other zone office personnel who spent all or a portion of their time visiting and working with the dealers included an assistant zone manager (fifty per cent of his time); a business management manager (seventy-five per [fol. 710] cent); a parts and service manager (seventy-five per cent); a claims administrator and his assistant (ninety per cent and one hundred per cent, respectively); and three service representatives (one hundred per cent). In addition to zone office personnel, national and regional Pontiac representatives made periodic visits to the zone.

With one exception, none of these Car Divisions maintained offices in the District. Chevrolet had a regional office in the District which supervised five zones. No dealer orders passed through the District office, but instead were sent directly to the Baltimore zone office, which also served the District. Personnel from Baltimore operated in the District in essentially the same manner as Pontiac's zone personnel. The Baltimore zone was responsible for processing owners' complaints regarding service by District dealers. It also initially passed upon applications for new dealerships, scrutinizing the business history and credit of an applicant. The regional office in the District then received the application and forwarded it with a recommendation to the Detroit office for final approval. A fleet manager worked out of Chevrolet's regional office in the District. His function was to be in touch with local and national fleet users and pro-

mote fleet orders. Approximately forty per cent of his time was spent in Washington.

The Cadillac Division had a less elaborate organization than the other Car Divisions, but it still maintained similar organizational control. Cadillac operated through independently-owned distributorships, which in turn appointed dealers. Each distributor, who was also a dealer, performed functions similar to the zone offices of the other divisions. In 1957 and 1958, there was one distributor in the District, who also had the only Cadillac dealership in the District. Two other dealers in the surrounding area were appointed by him. The distributor was the primary contact with Cadillac's central offices, [fol. 711] analogous to the zone offices of the other divisions. Dealers' reports, similar to those submitted by dealers in the other divisions, were channeled through the distributor to the Detroit office. A district manager employed by Cadillac supervised and coordinated the efforts of the seven distributors (forty-nine dealers) in the District and nearby states. He maintained a residence in the District and usually prepared his reports here. His primary function was to help the distributors, and through them the dealers, perform more efficiently.

Besides the Car Divisions, General Motors had several other operating divisions: GMC Truck & Coach Division operated under an organizational system similar to that of the four Car Divisions. It promoted the sale of vehicles and parts and supervised the activities of its dealers, who operated under Dealer Selling Agreements. There was one GMC Truck dealer in the District. A division representative and a service representative personally approached bus company customers in the District to promote coach sales and advise on service problems.

The Government Sales Section, the Cleveland Diesel Engine Division, the Detroit Diesel Engine Division, and the Allison Division also had offices in the District for the purpose of selling their products to the United States Government and to maintain general liaison with the Govern-

ment.[7] None of the car or truck divisions made Government sales.

[fol. 712] The United Motors Service Division, responsible for wholesale distribution of certain parts and accessories for General Motors products, maintained a zone office in the District. Orders taken in the District were filled from plants outside the District. The division maintained written agreements with wholesalers, seventeen of which were in the District.[8]

The AC Spark Plug Division maintained offices in the District only for liaison with the federal government. Non-government sales were made by personnel headquartered outside the District. Sales in the District made to wholesalers and national accounts, were made by a territory manager, whose duty was to promote sales through sales meetings with the seven warehouse distributors in the District, sales contests, and display and merchandising programs.

Several administrative offices were maintained in the District. GMAC and Motors Holding Division have been previously discussed. The Business Research Staff had the function of forecasting general economic conditions and their effect on the sale of company products. The General Motors Overseas Operations Division dealt with the United States and foreign governments and international agencies in respect of products sold abroad. The Patent Section conducted patent research and did some detail work regarding litigation. Its central Detroit office handled licensing and other business matters related

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[7] So far as the record indicates, income from operations of these divisions is not involved in this case. D.C.Code § 47-1557a (b)(13) excludes from the definition of "net income"

> "Income derived from the sale of tangible personal property to the United States by corporations. . . . having their principal places of business located outside the District, which property is delivered from places outside the District for use outside the District. . . ."

[8] It was the income derived from the operations of this division which General Motors originally contended was the only income taxable by the District.

to patents. The Public Relations Staff handled any necessary lobbying, relations with the press and other communications media, and general services to visiting executives.

[fol. 713] On the basis of past decisions of this court,[9] it is clear that General Motors is engaged in "trade or business" within the District, as that term is defined in the District Code.[10] The company does far more than promote the sale of its products in the District for the benefit of what it calls "independent contractors." The provisions of the Dealer Selling Agreements constitute a continuing business relationship with its "authorized dealers," in which General Motors exercises a large degree of control over daily business operations. Additional control was exercised through the financial aid given by Motors Holding Division and GMAC. "[General Motors had] supervisory control over at least a substantial part of the business of the local [dealer] or representative or at least a part-time claim on the services of the individuals or organizations acting for it."[11]

For the same reasons that General Motors' operations subject it to taxation in the District, the provisions of Public Law 86-272, § 101,[12] do not remove it from the taxable jurisdiction of the District. That law, enacted [fol. 714] in 1959, protects a business from taxation by a

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[9] *Lever Bros. Co.* v. *District of Columbia*, 92 U.S.App.D.C. 147, 204 F.2d 39 (1953); *cf. Fiat Motor Co.* v. *Alabama Imported Cars, Inc.*, 110 U.S.App.D.C. 252, 292 F.2d 745, *cert. denied*, 368 U.S. 898 (1961).

[10] D.C.Code § 47-1551c (h).

[11] *Lever Bros. Co.* v. *District of Columbia*, 92 U.S.App.D.C. at 149, 204 F.2d at 41.

[12] 73 Stat. 555, 15 U.S.C. §§ 381-84. The law was passed in response to the Supreme Court's decision in *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450 (1959). See Hirshberg & Nedry, *A Federal Concept of Doing Business*, 46 VA. L. REV. 1241 (1960); Roland, *Public Law 86-272: Regulation or Raid*, 46 VA. L. REV. 1172 (1960). For present purposes, we assume that the law applies to the District and to the taxable years involved.

State if the only business activities within the State involve solicitation of orders for the business itself, or for its prospective customers. The law's proscription applies only in the case of these minimal business contacts. We think the facts already outlined are sufficient to show that the activities of General Motors surpass any mere solicitation of business.[13]

General Motors recognizes that neither the District Code nor P.L. 86-272 removes it from all taxation by the District. In its brief, it states that "[I]t will be noted that these protective statutes, construed and applied as we urge, although they forbid the assessments made in this case, do not exempt [the company] from paying to the District a franchise tax based on net income." The controversy we face, therefore, is not one as to the District's jurisdiction to tax General Motors at all, nor as to the number of dollars arising from the so-called District sales. Our problem is as to the propriety of the formula used to identify, in General Motors total net income, that portion which may be reasonably thought to flow from the District activities and sales.

III

The first issue we confront is whether the District Code permits use of the single-factor sales formula. The question is not a new one in this court, although this is the first time the whole Court has had occasion to consider it.[14]

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[13] The act also protects a business which sells only through "independent contractors," which are defined as persons selling or soliciting sales "for more than one principal." General Motors' dealers are not in that category.

[14] The formula was specifically upheld as valid under the statute in *Smoot Sand & Gravel Corp.* v. *District of Columbia*, 104 U.S. App.D.C. 292, 261 F.2d 758, *cert. denied*, 359 U.S. 968 (1958), over the taxpayer's objection that its net income should have been "apportioned by a formula which takes into account its property values and operating costs, as well as sales; [and] that the regulation is invalid because it directs the apportionment of net income by considering only sales . . . ." In *Smoot*, we were in agreement with the Tax Court. However, three years later, in the first *Gallant*

[fol. 715] The statute, set forth above,[15] clearly does not require use of any particular formula. Nor can we discover a Congressional purpose or intent that a particular formula be utilized. The statute expressly delegates to the Commissioners the power to adopt any formula that will effectuate the taxing scheme devised by Congress. Thus, however much we might applaud a specific formula as a matter of wise fiscal and economic policy, we are not at liberty to substitute it for that adopted by the Commissioners. The most that we could do is to reject the Commissioners' approach as unauthorized.

The statute, in §§ 47-1580 and 47-1580a, contemplates three mutually exclusive sources of corporate net income taxable by the District. The first source, "allocated" to the District, is the income from a trade or business which is "carried on or engaged in wholly within the District." In such a situation, the gross income and expenses arise in the District, and the District is entitled to tax the en-[fol. 716] tire net income from the business. The second source, also "allocated" to the District, is "other income . . . derived from sources within the District." Again the gross income and expenses arise in the District, and the District may tax the entire net income.[16] The third source,

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case, *supra*, the Tax Court ruled the single-factor formula invalid as not authorized by the statute. We reversed the Tax Court on that point, citing *Smoot*. In the instant case, the Tax Court again held the single-factor formula invalid, noting that in *Smoot* "[T]he U. S. Court of Appeals evidently overlooked the mandate of the statute as to apportioning the income within and without the District. . . ." It is evident, however, from the reported decision in *Smoot* that the panel deciding that case, with full awareness of this and other provisions of the statute, held that the District Code does not preclude the use of a single-factor sales formula.

[15] See footnotes 1 and 2, *supra*.

[16] The District argues here that, regardless of whether General Motors' income from District sales is taxable under the provision applicable to corporations conducting a trade or business in the district, it is taxable as "other income . . . derived from sources within the District." Since the Tax Court held that the income from District sales was taxable under the "trade or business" provision and General Motors did not appeal that finding, and since

and the one in controversy here, is income from a trade or business conducted both within and without the District. The income from this source must be "apportioned," and only that portion attributable to the trade or business conducted in the District is taxable. The Commissioners' formula for making the required apportionment is as follows: Net income arising from activities within the District (and thus taxable) is to total net income of the corporation as sales made within the District is to total sales made by the corporation.[17]

[fol. 717] It is this formula for apportionment that General Motors challenges and the Tax Court held unauthorized under the statute It is contended that the sales formula adopted is in conflict with the taxing scheme and allots to the District a greater portion of the income of unitary interstate businesses than was intended. This contention is based upon a theoretically possible reading of certain key words of the statute. That reading is at least implicitly in conflict with prior interpretations by this court.[18]

The crucial language is: "If the trade or business of any corporation . . . is carried on or engaged in both within and without the District, *the net income derived*

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we find the income to be fully taxable under the "trade or business" provision, we need not at this time pass on the scope of the "other income" provision. However, it should be noted that this court has interpreted that provision to cover income arising from transactions outside the scope of a regular "trade or business" carried on within the District, such as rents, royalties, and income from the sale of real property. *District of Columbia* v. *Evening Star Newspaper Co.*, 106 U.S.App.D.C. 360, 273 F.2d 95 (1959); see *Lever Bros. Co.* v. *District of Columbia, supra.* The interpretation called for by the District would result in an overlap of the two provisions not called for by the taxing scheme.

[17] Regulations Pertaining to Income & Franchise Taxes, promulgated on August 6, 1953, § 10.2 (c)(1)(a), set forth in footnote 3 *supra.*

[18] See cases cited in footnote 14, *supra.* See also *Eastman Kodak Co.* v. *District of Columbia,* 76 U.S.App. D.C. 339, 131 F.2d 347 (1942) (considering the same question under the gross receipts tax in effect before 1947).

therefrom shall . . . be deemed to be income from sources within and without the District." [Emphasis added.] D.C. Code §.47-1580a. General Motors and the Tax Court would interpret the words italicized to refer to net income *arising from activities in the Distict.* In this case, those activities principally involve sales. They then argue that the net income so earned must be "deemed to be income from sources within and without the District." Thus, the apportionment called for must be an apportionment of only this income. A permissible formula, under this interpretation, would first require a determination of the net income on the sales made in the District. Apparently the sales-income ratio would be appropriate for this purpose. But this is only the first step. The net income so determined would then be "apportioned" under a formula which would assign a part of the net income to each step in the manufacture-distribution process. This would recognize the fact [fol. 718] that each step "earns" part of that income. The District would only be permitted to tax that part of the net income "earned" by the steps in the process which occur in the District, in this case principally the final sales step.[19] The District would not be permitted to tax that income economically attributable to the processing stages before sale, since they occur outside the District. This would call for some cost accounting formula that would divine the exact amount of income generated by each element of the manufacturing and distributing process through which a particular product passes on its way from raw materials to ultimate sale. They argue that the three-factor formula, while not a precise cost accounting method of separating and applying the net income from a sale to the various stages, is a rough equivalent and is therefore authorized by the statute, but that the single-factor sales formula is not authorized since it does not even attempt such an application.[20]

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[19] They concede that the income "earned" on activities in the District other than sales would also be taxable under this scheme.

[20] Whether anything short of a precise cost accounting system, which would fairly apply the net income to the various processes, would satisfy General Motors' reading of the statute is a serious

The District, on the other hand, argues, and we think [fol. 719] correctly, that the net income to be apportioned is the net income from the entire business of the corporation rather than that income arising solely from District sales. To read the statute as General Motors requests, the word "therefrom" must refer only to net income arising from that part of a trade or business carried on *within* the District. But it seems clear to us, from a simple reading of the words used, that "therefrom" refers to the income earned internally *and* externally by a corporation that carries on a trade or business both within and without the District, that is to say, its total income. Only by putting in language which does not appear can "net income" be restricted to that arising only from District sales. Read as we read it, the statute clearly permits, although it does not require, the single-factor sales formula adopted by the Commissioners.

The General Motors interpretation is obviously a complex and sophisticated one. We believe it more probable that the District's approach reflects the intent of Congress. A court should not apply a taxing statute more narrowly than its clear language imports unless there is some showing of Congressional intent that it should do so. The revenue act of which the franchise tax is a part was passed in 1947 to raise desperately needed revenues for the District. It was subjected to extensive study by a joint committee of Congress;[21] it was debated at length

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but moot question. It is not at all clear that the three-factor formula is even a close approximation of the kind of economic breakdown called for. While there is some relationship between the cost of payroll and property attributable to a certain stage and the income arising from that stage, it is not at all certain what that relationship is. Moreover, the sales process, being the end product of all the other stages and responsible for the actual receipt of the *money* income, could be said to be the most important stage, thus permitting a greater proportionate share of the income to be assigned to it vis-a-vis the other steps in the process.

[21] See *Hearings Before the Joint Subcommittee on Fiscal Affairs of the Committee on the District of Columbia on Methods of Acquiring Additional Revenue Through Taxes and Other Means*, 80th Cong., 1st Sess. (1947).

in the House and to a lesser extent in the Senate;[22] and several reports were written concerning it.[23] Nowhere in [fol. 720] this material is there any indication that the crucial language in this section was intended to be read as General Motors suggests. This seems particularly important since, as we pointed out in the *Smoot* case, the prior gross receipts tax has been interpreted by this court to permit a single-factor sales formula similar to that presently used by the District.[24] It would seem that any intended change in application would have been indicated clearly by Congress.

Thus, we must find that the apportionment required relates to the entire net income of the corporation. We hold that the single-factor sales formula is permitted by the statute and, unless it is unconstitutional, the Tax Court must be reversed.

As noted above, the Tax Court invalidated the single-factor formula in this instance solely by reference to the statute and not to the Constitution. It expressly disclaimed the latter as a ground of decision because of the [fol. 721] uncertainties it entertained as to its own status,

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[22] See, *e.g.*, 95 Cong. Rec. 6629 (1947) (House); 95 Cong. Rec. 7357 (1947) (Senate).

[23] House Comm. on the District of Columbia, *Tax Legislation for the District of Columbia, Re: H.R. 3737*, Committee Print, 80th Cong., 1st Sess. (1947); S. Rep. No. 280, 80th Cong., 1st Sess. (1947); H.R. Rep. No. 543, 80th Cong., 1st Sess. (1947); H.R. Rep. No. 699, 80th Cong., 1st Sess. (1947); H.R. Rep. No. 801, 80th Cong., 1st Sess. (1947).

[24] See *Panitz* v. *District of Columbia*, 74 U.S.App.D.C. 284, 122 F.2d 61 (1941); *Eastman Kodak Co.* v. *District of Columbia, supra.* Moreover, the regulations promulgated in 1947, immediately after the Act was passed, included the same sales formula now in use. Regulations Pertaining to Income and Franchise Taxes, promulgated August 28, 1947, § 10-2 (d)(1). The Commissioners participated actively in the drafting of the Act and it would seem that they would have been aware of any intended change. This is not to say that, since they participated in the drafting, anything they do reflects the intent of Congress. However, if a change was intended, it would seem that the District officials would have at some point in the legislative process spoken out on the matter.

i.e., court or administrative agency. We see no need to pursue this problem at this time, but we do think it appropriate to note that the record in this case was made up of evidence taken by the Tax Court, and its findings of fact are to be treated with the respect customarily accorded to the trier by a reviewing body.

One of those findings might well be thought to be conclusive upon us, absent any demonstration by us of a lack of foundation for it in the record. This is the last of the findings, No. 6, which is as follows:

> "The method used by the assessing authority of the District attributed to the District 100 per centum of the net income derived by the petitioner from that segment of its business which consisted of the manufacture without, and sale of the products within the District. The percentage thus determined was out of all reasonable proportion to the trade or business carried on or engaged in by petitioner within the District."

It seems evident that the first sentence of this finding is the premise for the second, which latter, standing alone and undisturbed, would take the taxpayer here beyond the reach of the taxing statute. The premise in this instance, although stated in factual terms, appears to us to reflect the faulty reading of the statute which we have discussed at length immediately hereinabove. In other words, the premise assumes that the net income to be apportioned is only that derived from transactions which touch upon the District of Columbia, as distinct from the total net income of General Motors from its operations at large, including those physically related to the District of Columbia.

To the extent, therefore, that No. 6 is a true finding of fact, it rests upon an erroneous view of the applicable law; and, therefore, we do no violence to sound principles of appellate review when we conclude that this finding [fol. 722] does not dictate our decision. We need not demonstrate that the particular fact found is untrue if it is irrelevant.

IV

Our inquiry, however, is not finished with the determination that the District Code permits the tax formula in use. We turn to the claim that the single-factor sales formula violates the due process clause by unreasonably apportioning income which properly has no relation to business done in the District, and the commerce clause by imposing an excessive burden of taxation.

That a single-factor formula is not inherently arbitrary or unreasonable is too well-settled to be subject to doubt at this late date.[25] Nor is this controverted by the holdings in other cases that multi-factor formulas are also constitutional.[26] The question remains, however, whether as to this taxpayer the tax is arbitrary and unreasonable. The burden of showing this is on the taxpayer; and the burden is a heavy one. "One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed." *Butler Bros.* v. *McColgan*, 315 U.S. at 307. General Motors concedes that it was subject to taxation by the District. The company has not sustained its burden of showing that the tax levied on it, as [fol. 723] determined by the single-factor sales formula, was "not reasonably attributable"[27] to the business transacted in the District so as to result in the taxation of extraterritorial values.

The evidence offered by General Motors in the Tax Court showed that only a small percentage of its prop-

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[25] *Smoot Sand & Gravel Corp.* v. *District of Columbia, supra; Eastman Kodak Co.* v. *District of Columbia, supra; Panitz* v. *District of Columbia, supra; Ford Motor Co.* v. *Beauchamp*, 308 U.S. 331 (1939); *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Comm'n*, 266 U.S. 271 (1924); *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920).

[26] *Northwestern States Portland Cement Co.* v. *Minnesota, supra; International Harvester Co.* v. *Evatt*, 329 U.S. 416 (1947); *Butler Bros.* v. *McColgan*, 315 U.S. 501 (1942); *United States Glue Co.* v. *Town of Oak Creek*, 247 U.S. 321 (1918).

[27] *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123, 133 (1931).

erty and payroll was located in the District. On the basis of testimony given by the economist-witnesses that, from an economic standpoint, income must be spread across the entire manufacturing process which precedes the ultimate sale in order to reflect the points where that income was actually "earned," the Tax Court found that a three-factor formula must be utilized to reflect accurately the income taxable in the District. With this finding, General Motors now contends that it has met the burden of showing the tax "not reasonably attributable" to its business conducted in the District. We disagree. An analysis of Supreme Court decisions illustrates that proof that a tax is not in reasonable proportion to business conducted must be much more detailed and specific than that adduced here.

In *Underwood Typewriter Co.* v. *Chamberlain, supra,* the Supreme Court held that the taxpayers had not sustained their burdens of showing that the taxes involved were arbitrary and unreasonable. The State of Connecticut imposed a tax on net income based on a single-factor property formula, which resulted in a tax on forty-seven per cent of Underwood's income. Underwood relied upon a showing that most of its receipts were from sales made outside the State:

> "But this showing wholly fails to sustain the objection. The profits of the corporation were largely earned by a series of transactions beginning with man- [fol: 724] ufacture in Connecticut and ending with sale in other States. In this it was typical of a large part of the manufacturing business conducted in the State. The legislature in attempting to put upon this business its fair share of the burden of taxation was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders. It, therefore, adopted a method of apportionment which, for all that appears in this record, reached, and was meant to reach, only the profits earned within the State." [28]

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[28] 254 U.S. at 120-21. The burden which *Underwood* failed to carry was " 'showing that 47 per cent of its net income [was] not reasonably attributable, for purposes of taxation, to the manufac-

It should be noted that in this quotation the Supreme Court accepted the economic theory here advanced by General Motors, namely, that "[T]he profits were largely earned by a series of transactions beginning with manufacture . . . and ending with sales. . . .". The theory proved the case in *Underwood* no better that it does here. [fol. 725] The case most strongly relied on by General Motors in its constitutional argument does not closely resemble the one before us. In *Hans Rees' Sons, Inc.* v. *North Carolina, supra,* the Supreme Court held that a North Carolina income tax based upon a single-factor property formula was arbitrary and unreasonable as applied to the taxpayer, who was engaged in the manufacture and sale of leather goods. In this case the Supreme Court was confronted with this characterization of the evidence by the North Carolina Supreme Court:

> "Without burdening this opinion with detailed compilations set out in the record, the evidence offered by the petitioner tends to show that for the years 1923, 1924, 1925, and 1926, the average income having its source in the manufacturing and tanning operations within the State of North Carolina was seventeen per cent" (quoted at p. 127 of 283 U.S.).

At the same time, the evidence showed that, for the same year, the percentage of the taxpayer's total net income

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ture of products from the sale of which 80 per cent of its gross earnings was derived after paying manufacturing costs.'" *Ibid.*

The taxpayer in *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Comm'n, supra,* engaged in brewing (done wholly in England) and selling ale, some of which was sold in New York through branch offices, also failed to meet its burden of showing that the New York franchise tax was unreasonable as applied to it.

> ". . . [A]s the Company carried on the unitary business of manufacturing and selling ale, in which its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places—the process of manufacturing resulting in no profits until it ends in sales—the State was justified in attributing to New York a just proportion of the profits earned by the Company from such unitary business."

266 U.S. at 282.

apportioned to North Carolina by the formula in question averaged eighty percent. Accepting these facts as found by the state court, and setting the resulting sets of figures against each other, the Supreme Court stated:

> "... [I]n any aspect of the evidence, ... the statutory method, as applied to the appellant's business for the years in question operated unreasonably and arbitrarily, in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted by the appellant in that State. In this view, the taxes as laid were beyond the State's authority." [29]

Unlike the proof adduced in *Hans Rees' Sons*, the evidence here did not undertake to show that the District of Columbia operations accounted for an identified percentage of General Motors total net income, which percentage could, as in *Hans Rees' Sons*, be compared with that taxed [fol. 726] under the single-factor formula. The testimony offered by General Motors was largely that of economists who described the unitary character of the manufacturing and selling operations as respects the generation of profits, and who urged the three-factor formula as the one most likely to attribute a fair share of these profits to the District activities. Economic experts offered by the District dissented from this latter view, and insisted that the one-factor sales formula was a reasonable choice among alternative methods. Nowhere in the record do there appear specific percentages of the kind accepted by the Supreme Court in *Hans Rees' Sons*. That case, therefore, does not compel the decision in this; and, indeed, the evidence in the present record leaves us in the position in which the Supreme Court found itself in *Underwood Typewriter* and *Bass*.

"[T]he economic wisdom of state net income taxes is one of state policy not for our decision ..." [30] Indeed, there

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[29] 283 U.S. at 135-136.

[30] *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. at 462.

is no unity of agreement even among economists as to the factors which should be used or the weight each should be given in a reasonably accurate formula for state taxation of multi-state business.[31] Quite obviously, this court has no sound basis for ruling that one formula rather than another must be followed as the only legally permissible one, in the absence of a tangible demonstration, as in *Hans Rees' Sons,* [fol. 727] that the formula under attack is operating indefensibly. The demonstration itself conceivably might take different forms, but each must reveal some concrete circumstance by which arbitrariness and irrationality, in the constitutional degree, may be identified.

V

The second constitutional attack by General Motors on the District's formula is based on an asserted violation of the commerce clause. A state-imposed income tax on a corporation which operates in interstate commerce does not violate the commerce clause merely because of that fact. The tax may be invalid if the corporation engaged "exclusively" in interstate commerce, with no local intrastate business. *Spector Motor Service, Inc.* v. *O'Connor,* 340 U.S. 602 (1951). Or it may be invalid if it discriminates against interstate commerce "either by providing a direct commercial advantage to local business, *Memphis Steam Laundry* v. *Stone,* 342 U.S. 389 (1952) . . . [*cf. Halliburton Oil Well Cementing Co.* v. *Reily,* 373 U.S. 64 (1963)], or by subjecting interstate commerce to the burden of 'multiple taxation,' *Michigan-Wisconsin Pipe Line Co.* v. *Calvert,* 347 U.S. 157 (1954) . . ." [32] However, a tax which is fairly apportioned to

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[31] See Barber, *State Taxation of Net Income Derived from Interstate Commerce,* 48 A.B.A.J. 1133 (1962), and Britton, *State Taxation of Extraterritorial Value: Allocation of Sales to Destination,* 46 VA. L. REV. 1160 (1960), both of whom criticize the inclusion of a sales factor in an apportionment formula. For a short history of the varying proposals by tax experts for more perfect apportionment, see RATLIFF, INTERSTATE APPORTIONMENT OF BUSINESS INCOME FOR STATE INCOME TAX PURPOSES, pp. 17-28 (1962).

[32] *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. at 458.

local activities, and is non-discriminatory, is a valid exercise of the State's taxing powers. "While it is true that a State may not erect a wall around its borders preventing commerce an entry, it is axiomatic that the founders did not intend to immunize such commerce from carrying its fair share of the costs of the state government in return for the benefits it derives from within the State." *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. at 461-62.

[fol. 728] General Motors bases its commerce clause argument only on the ground that the District's single-factor formula discriminates against interstate commerce by resulting in unconstitutional double taxation of its income. It is undisputed that, as found by the Tax Court, the vehicles sold to customers in the District were manufactured largely in Michigan, Maryland, and Delaware. In the taxable years in question, General Motors paid these States a tax based on its net income, apportioned by each State on the basis of a three-factor formula of property, payroll, and sales, equally weighted.[33] This, of course, is the formula advocated in this case by the company.

As with the due process contention, the burden is on General Motors to show by specific evidence that "double taxation" would result from the application of the District's formula. This it has failed to do. The company has produced only a hypothetical situation to prove its case: "Assume that Chevrolet has a net income of $3,000,000 derived from the manufacture and sale of automobiles sold to customers located in the District; that three-fourths of the manufacturing activity takes place in Michigan and one-fourth (including the activities of the zone or 'sales' office) takes place in Maryland. Michigan would tax 50% of the income (one-third of 75% property, 75% payroll,

---

[33] The taxes paid were:

Year	*State*	*Amount*
1957	Michigan	$8,955,799.55
1958	Michigan	6,940,309.50
1957	Maryland	510,792.31
1958	Maryland	271,425.75
1958	Delaware	127,844.95

0% of sales); Maryland would tax 16⅔% (one-third of 25% property, 25% payroll, 0% sales); and the District would tax 100% (sales alone). Chevrolet is taxed by the three states combined on 166⅔% of its total income."
[fol. 729] Aside from the economic arguments that the income from these sales were attributable to operations in jurisdictions outside the District, no showing was made that the relatively minor portions of sales were not reasonably attributable to the concededly relatively minor scope of operations in the District. This court recognized in *Broadcasting Publications, Inc.* v. *District of Columbia* that exactitude is not possible in apportionment formulas:

> "In allocating Taxpayer's income for franchise tax purposes, neither the statute nor the Regulations attempt to determine what precise percentage of the income is attributable to each separate facet of the publication process and then allocate it geographically. That is unrealistic if not impossible." [34]

Secondly, and perhaps more importantly, the uniformity produced by the use of similar factors is more apparent than real. General Motors has pointed to only one facet of the apportionment process by which the tax structures of Michigan, Maryland, and Delaware, are similar to each other, and dissimilar to the District's structure. That facet consists of the factors which each uses to apportion business income to the respective states. However, the methods used to arrive at the portion of each factor which is attributable to the particular state are at least as important as the factors themselves in determining whether or not tax structures are similar. Similarity may or may not exist in the definition of local sales, the accounting procedures used, and the deductions permitted from

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[34] —— U.S.App.D.C. ——, ——, 313 F.2d 554, 559 (1962). See also *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. at 121, where the Supreme Court referred to "the impossibility of allocating specifically the profits earned by the processes conducted" within the borders of the taxing state.

gross income in order to arrive at net income.[35] In short, General Motors has not shown that the District's single-[fol. 730] factor sales formula would impose a burden of double taxation.

> "Logically it is impossible, when the tax is fairly apportioned, to have the same income taxed twice. In practical operation, however, apportionment formulas being what they are, the possibility of the contrary is not foreclosed . . . . There is nothing to show that multiple taxation is present. We cannot deal in abstractions. In this type of case the taxpayers must show that the formula places a burden upon interstate commerce in a constitutional sense. This they have failed to do." [36]

VI

Nothing that we have said should be taken to mean that [fol. 731] the single-factor sales formula is the *only* permissible formula which the District Commissioners might

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[35] See Studenski, *The Need for Federal Curbs on State Taxes on Interstate Commerce: An Economist's Viewpoint*, 46 VA. L. REV. 1121 (1960); Barber, *supra* note 31, at 1135. RATLIFF, *op. cit. supra* note 31, at 29-31, states:

> "Uniformity does not exist to the degree, however, that the [similarity of factors used] may suggest, for the factors are defined variously by the states. For example, among the locations to which sales are assigned are the locations of the following: office where negotiated, property at time of order, receipt or acceptance of order, negotiating personnel, point of delivery, and origin of shipment. Among the bases for allocating payrolls are: office location, time spent in the state, and compensation earned in the state.
>
> Generally the states provide for the direct allocation of certain types of income, such as capital gains, rents, royalties, dividends, and interest. However, 6 of the [states imposing a net income tax] make no provision for the direct allocation of any income. Usually states allow separate accounting in cases where the taxpayer shows that it more clearly reflects the income attributable to the state than does the formula, but again there are 6 that do not allow it."

[36] *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. at 462-63.

adopt under the authority committed to them by Congress in the taxing statute. Our holding is only that neither the District Code nor the Constitution *prevents* the use of the present formula of apportionment. On March 22, 1961, the Finance Officer of the District recommended to the Commissioners that they adopt the same three-factor formula which General Motors here advocates. The District's Director of General Administration added his recommendation that the formula be approved. Adoption of the new formula would bring the District into line with the apportionment formulae now used by twenty-five of the thirty-seven States and the District of Columbia which levy taxes on or measured by net income.[37] The Finance Officer stated that the formula has been endorsed for use by all of the States on a uniform basis by a number of expert and informed groups. We have no reason to doubt the authority of the Commissioners to adopt a property-payroll-sales formula. What we said in *Smoot* is equally applicable to our holding in this case: "The value and situs of the corporation's property used in its operation could doubtless have been ruled to be a permissible factor in apportioning income . . . but to say that this would be permissible does not demonstrate that it must be considered an indispensable factor."[38]

However, the judicial branch has neither the mandate nor the machinery to make the policy determinations implicit in the choice of an apportionment formula. This [fol. 732] is a legislative responsibility which has been reposed by Congress in the District Commissioners, and its wise discharge necessitates the use of legislative methods of inquiry into, and resolution of, issues affecting the interests of the District, of which maximum tax revenue is but one. This court can deal only with the individual case as it arises, and once it is determined that a legislatively

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[37] These figures are found in RATLIFF, *supra* note 31, at 29-30. Not included in the author's computation, but added here, is the State of Michigan, which also employs a three-factor formula.

[38] *Smoot Sand & Gravel Corp.* v. *District of Columbia*, 104 U.S. App.D.C. at 298-99, 261 F.2d at 764-65.

adopted formula is not prohibited by statute or the Constitution, our task is complete. As Mr. Justice Frankfurter has stated:

> "The complexity of the proposals of the [Civil Aeronautics] Board's Report—the items to be taken into account, the balance to be struck among them, the problem of giving the States their due without unfairly burdening an industry of vital national import—indicates how ill-adapted the judicial process is, as against the choices open to Congress, for dealing with these problems and how warily this Court should move within the limits of its own inescapable duty to act. The protection of interstate commerce against the burden of multiple taxation ought not to be left to litigation growing out of changes in the methods of taxation.
>
> 'The immunities implicit in the Commerce Clause and the potential taxing power of a State can hardly be made to depend, in the world of practical affairs, on the shifting incidence of the varying tax laws of the various States at a particular moment. Courts are not possessed of instruments of determination so delicate as to enable them to weigh the various factors in a complicated economic setting which, as to an isolated application of a State tax, might mitigate the obvious burden generally created by a direct tax on commerce.' *Freeman* v. *Hewitt*, 329 U. S. 249, 256." [39]

[fol. 733] Having found that the single-factor sales formula employed by the District is permitted by the District Code, and not shown on this record to be violative of the Constitution, we hold that the franchise tax levied against the General Motors Corporation for the years 1957 and 1958 was a valid one. The decisions of the District of Columbia Tax Court are accordingly,

Reversed

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[39] *Braniff Airways, Inc.* v. *Nebraska State Bd. of Equalization & Assessment*, 347 U.S. 590, 606 (1954) (dissenting opinion).

DANAHER, *Circuit Judge*, dissenting: This court in *Smoot Sand and Gravel Corp.* v. *District of Columbia*[1] was urged to consider a three-factor formula consisting of manufacturing costs, business property located in the District and sales made here. But the opinion noted that no evidence had been offered to compel acceptance of that formula. Moreover, the petitioner had failed to show that an arbitrary and unreasonable result flowed from the regulation which directed the apportionment of net income by considering only sales. Thus we refused to say that the assessments were invalid and erroneous.

Here the Tax Court, after noting that most of the facts and the evidence based upon exhibits had been stipulated, further found:

> "5. The segment of petitioner's business which was conducted both within and without the District of Columbia consisted of the manufacture of a certain number of automobiles and kindred products without the District and the sale thereof to customers within the District. The net income from this segment of petitioner's business was earned by a series of transactions beginning with the manufacture of [fol. 734] products in several states and ending with the sale to customers in the District. While the net income was not realized until sale, it was earned in part by manufacture of the products sold, including in addition to actual manufacture, procurement of material, financing, use of property and administration.
>
> "6. The method used by the assessing authority of the District attributed to the District 100 per centum of the net income derived by the petitioner from that segment of its business which consisted of the manufacture without, and sale of the products within the District. The percentage thus determined was out of all reasonable proportion to the trade or business carried on or engaged in by petitioner within the District."

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[1] 104 U.S.App.D.C. 292, 298, 261 F.2d 758, 764 (1958), *cert. denied*, 359 U.S. 968 (1959).

With *Smoot Sand and Gravel* before it, the Tax Court expressly found that the District's use of the single-factor sales formula had allocated to the District all of the petitioner's income, earned at all stages, although only certain final sales had occurred in the District. Thus the sales formula failed to apportion petitioner's income as the Code commanded where income from a sale within the District was actually earned "partly within and partly without" the District.

> "If the trade or business of any corporation . . . is carried on or engaged in both within and without the District, the net income derived *therefrom* [that is, from *business* so carried on or engaged in both within and without the District] shall . . . be deemed to be income from sources within and without the District." D. C. CODE § 47-1580a (1961). (Emphasis added.)

The same section next provides that where net income is so derived, the *portion* subject to tax shall be determined under regulations prescribed by the Commissioners. Clearly the purpose of the statute is to reach only a "proper"—*i.e.*, an equitable and just—"portion" which shall be subject to tax. To that end, the Code authorized the [fol. 735] Assessor to employ "any formula or formulas" provided by regulation "which, *in his opinion, should* be applied in order to *properly* determine the net income . . . subject to tax." (Emphasis added.) The language speaks in terms of what is right and reasonable and just and equitable according to the facts. At least that much is required to save the tax from becoming an invalid imposition. The Assessor is not empowered broadly to utilize "any formula," but only one which "should" be utilized that the amount of tax be "properly" determined. And we have so held:

> "It seems clear from the statutory provisions considered as a whole that the Assessor is vested with discretion to select the most appropriate formula from among those set out in the regulations. Where no appropriate formula appears in the regulations, we

> think he has authority to devise one which in his judgment will properly determine the net income subject to tax and the correct amount of the tax. His determination is of course subject to review in the courts." *District of Columbia* v. *Gallant Incorporated*, 110 U.S. App.D.C. 202, 204-05, 290 F.2d 745, 747-48 (1961).

Even if the Assessor shall have failed so to act, the Tax Court itself can not be precluded for lack of a regulatory formula, from determining the income which is fairly apportionable to the District, we said. Accordingly, we remanded the case to the Tax Court, thus:

> "The Tax Court is directed to determine the amount of the income which is fairly attributable to the District by applying the August 6, 1953, regulations, including if necessary the use of such formula or formulae as the Tax Court deems best suited for determination of that question in this case." 110 U.S.App. D.C. at 205, 290 F.2d at 748.

It does not do for the majority simply to say that as to *some* corporations and in *some* situations a single-factor [fol. 736] formula may validly be utilized.[2] Nor is it an answer to *this* taxpayer's contentions that the records in *some* cases have shown no more than the single-factor formula has not resulted inequitably. We are here dealing with a record which overwhelmingly sustains the Tax Court's findings. I deem its conclusion inescapable that the single-factor sales formula utilized by the Assessor was here proved to be arbitrary and inequitable in its result, and therefore not consistent with the requirement of the Code. Having reached that conclusion, the Tax Court did precisely what we said should be done to determine an

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[2] See, e.g., District of Columbia v. Gallant, Incorporated, 113 U.S.App.D.C. 92, 305 F.2d 761 (1962). After our remand in the first Gallant case, text *supra*, the Tax Court found the sales formula best suited in the circumstances. We affirmed the result as just and reasonable even as we observed that the sales test is not the only or necessarily the best test. Other factors may be equally or even more relevant, we noted.

equitable tax. Agreeably to the *Gallant* directive, *supra*, the Tax Court applied "such formula or formulae as the Tax Court deems best suited for determination of [the petitioner's net income] in this case."

Consistently with what we had said was its duty to use the formula best suited to the determination required by the Code, the Tax Court turned to the three-factor formula substantially as set forth in the Uniform Division of Income for Tax Purposes Act.[3] The Tax Court's decision noted that the parties had stipulated facts sufficient for the application of that formula. A study of the findings not [fol. 737] only bears out that conclusion, but in my view, necessarily impels a rejection of the single-factor sales formula *as here applied*. I would affirm the Tax Court's decision.[4]

WILBUR K. MILLER and BASTIAN, *Circuit Judges*, concur in the foregoing dissenting opinion.

BURGER, *Circuit Judge, concurring in part and dissenting in part*: I agree with the majority that the Tax Court is probably without power to construct a three-factor formula to be substitute for the one-factor formula used by the Assessor. That the Tax Court's formula makes sense and the Assessor's does not is not the issue; rather it is a matter of where the power resides. I join with the dissent in viewing the Assessor's action as arbitrary and I would go further and hold that it is legally arbitrary and capricious, and hence violative of the statute under which the

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[3] Approved 1957, by the National Conference of Commissioners on Uniform State Laws and by the American Bar Association; and see *State Taxation of Net Income Derived from Interstate Commerce*, 48 A.B.A.J. 1133 (December 1962).

[4] The Finance Officer on March 22, 1961 recommended that the Commissioners adopt the three-factor formula as "the most accurate and equitable method yet devised for apportioning among the States the taxable net income of corporations operating in a number of States." The Commissioners on March 28, 1961 approved the proposed amendments to the regulations with such amendments as might appear necessary after public hearing, all to become effective as of January 1, 1962. With this case impending, final action seems to have been postponed.

District purported to act. I would remand to require a reassessment of the tax, precluding the use of the one factor formula. Concluding that the Assessor's action was violative of the statute, I need not now reach the issue whether it was also violative of any constitutional protections.

[fol. 738] [File endorsement omitted]

IN THE UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1963

Nos. 17,017-8

Docket Nos. 1698 and 1699

DISTRICT OF COLUMBIA, Petitioner,

v.

GENERAL MOTORS CORPORATION, Respondent.

On Petitions for Review of Decisions of the District of Columbia Tax Court.

Before: Bazelon, Chief Judge, and Wilbur K. Miller, Fahy, Washington, Danaher, Bastian, Burger, Wright and McGowan, Circuit Judges, sitting *en banc*.

JUDGMENT—February 13, 1964

These cases came on to be reheard en banc on the record from the District of Columbia Tax Court, and were reargued by counsel.

On Consideration Whereof, it is ordered and adjudged by this court that the decisions of the Tax Court on review herein are reversed, and these cases are hereby remanded to the District of Columbia Tax Court for proceedings not inconsistent with the opinion of this court.

It is further Ordered by the court that petitioner recover from respondent its taxable costs in these cases.

Per Circuit Judge McGowan.

Dated: February 13, 1964.

Chief Judge Bazelon and Circuit Judges Fahy, Washington and Wright join in the majority opinion by Circuit Judge McGowan.

Separate dissenting opinion by Circuit Judge Danaher.

Circuit Judges Wilbur K. Miller and Bastian concur in Judge Danaher's dissenting opinion.

Separate opinion by Circuit Judge Burger concurring in part and dissenting in part.

[fol. 740] [File endorsement omitted]

IN THE UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 17,017 and 17,018

DISTRICT OF COLUMBIA, Petitioner,

v.

GENERAL MOTORS CORPORATION, Respondent.

On Petition for Modification of Judgment

PER CURIAM—Filed May 7, 1964

Messrs. Chester H. Gray, Corporation Counsel, *Milton D. Korman,* Principal Assistant Corporation Counsel, *Henry E. Wixon* and *Robert E. McCally,* Assistant Corporation Counsel, were on the pleadings for petitioner.

Messrs. Donald K. Barnes, of the bar of the Supreme Court of Michigan, appearing for respondent *pro hac vice*, and *William T. Plumb, Jr.*, were on the pleadings for respondent.

Before: Bazelon, Chief Judge, Wilbur K. Miller, Fahy, Washington, Danaher, Bastian, Burger, Wright and McGowan, *en banc*.

Per Curiam: In the prior opinion of this court in these cases, it was stated at page seven of the slip opinion that:

> "General Motors paid the assessment under protest, [fol. 741] and appealed to the Tax Court. In that court, two primary arguments were urged as to the invalidity of the assessed deficiencies; one, that the numerator of the sales formula was too broad, in that it included sales which were not 'District sales'; and, two, that use of the single factor apportionment formula itself was permitted neither by the District Code nor by the Constitution."

On page eight this court stated that:

> "For the purposes of this appeal, [General Motors] appears to concede the correctness of the figures found by the Tax Court as representing 'District sales'. The controversy before us, therefore, does not relate to the definition of what sales by General Motors may properly be taken to be 'District sales', made in the course of a business activity which is carried on both within and without the District. It relates, rather, to the formula to be used for apportioning to the District that part of General Motors entire net income attributable to its 'District sales'."

General Motors has petitioned for a modification of this court's judgment to the limited extent of remanding the cases to the Tax Court for consideration of the application of the regulation embodying the single-factor formula to the facts. It is said that, since the Tax Court found that regulation invalid and proceeded to apply one of its own, there was never any adjudication of the contentions

made by the taxpayer as to the proper scope of the application of the former to its D. C. operations. There having been no ruling on these contentions, adverse or otherwise, there was, of course, nothing to be made the subject of an appeal, or to be waived, by the taxpayer.

We find this request to be meritorious and, indeed, consistent with the above-quoted passages from our prior opinion. We are also satisfied from an examination of the record that this issue was not stipulated away by General Motors. General Motors, is, it seems to us, entitled to press, and to have resolved, its contentions with [fol. 742] respect to the proper determination of "District sales" for purposes of a one-factor formula regulation which we, unlike the Tax Court, have found to be valid.

The petition is, accordingly, granted; and our earlier judgment is modified to the extent of providing that the reversal of the Tax Court decisions is to be accompanied by remand to the Tax Court for such further proceedings as are not inconsistent herewith.

It is so ordered.

Wilbur K. Miller, Danaher and Bastian, *Circuit Judges*, dissenting: Even as modified the majority opinion remains unacceptable to us. We adhere to the position more fully stated in our original dissent.

[fol. 743] [File endorsement omitted]

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT
September Term, 1963
No. 17,017
17,018

DISTRICT OF COLUMBIA, Petitioner,

v.

GENERAL MOTORS CORPORATION, Respondent.

DISTRICT OF COLUMBIA, Petitioner,

v.

GENERAL MOTORS CORPORATION, Respondent.

Before: Bazelon, Chief Judge, and Wilbur K. Miller, Fahy, Washington, Danaher, Bastian, Burger, Wright, and McGowan, Circuit Judges, in Chambers.

ORDER—May 7, 1964

On consideration of respondent's petition for modification of this Court's judgment of reversal, dated February 13, 1964, of the opposition thereto by the District of Columbia, and of respondent's reply, it is

Ordered by the Court that respondent's aforesaid petition for modification is hereby granted.

Per Curiam.

Dated: May 7, 1964

Circuit Judge Burger did not participate in the foregoing order.

[fol. 747] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 748]

SUPREME COURT OF THE UNITED STATES

No. 352—October Term, 1964

GENERAL MOTORS CORPORATION, Petitioner,

vs.

DISTRICT OF COLUMBIA.

ORDER ALLOWING CERTIORARI—October 26, 1964

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit is granted, and the case is placed on the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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JOHN F. DAVIS, CLERK

No. 352

IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

GENERAL MOTORS CORPORATION,
Petitioner,

v.

DISTRICT OF COLUMBIA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. ———

GENERAL MOTORS CORPORATION,
Petitioner,

v.

DISTRICT OF COLUMBIA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioner, General Motors Corporation, respectfully prays that a writ of certiorari issue to review the judgments of the United States Court of Appeals for the District of Columbia Circuit entered in these cases on February 13, 1964, as modified on May 7, 1964.

OPINIONS BELOW

The findings of fact and opinion of the District of Columbia Tax Court (R. 484-533, 559-567) are not officially reported and are printed as amended in Appendix A hereto, p. 1a, *infra*. The majority and dissenting opinions of a division of the Court of Appeals are

printed in Appendix B hereto, p. 42a, *infra*. The majority and dissenting opinions of the Court of Appeals on rehearing *en banc*, printed in Appendix C hereto, p. 46a, *infra*, are reported at —— F.2d——.

JURISDICTION

The judgments of the Court of Appeals on rehearing *en banc* were entered on February 13, 1964, Appendix D, p. 82a, *infra*. A petition for rehearing to modify the judgments was timely filed on February 25, 1964 and was granted on May 7, 1964, —— F.2d ——, Appendix E and F, pp. 83a, 85a, *infra*. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

I. ***Interstate Commerce, Due Process and Territorial Jurisdiction.***

Whether the single-factor sales formula for the "apportionment" of net income, prescribed by the Commissioners of the District of Columbia purportedly under authority of the District of Columbia Income and Franchise Tax Act of 1947, is invalid:

(a) as repugnant to the Due Process Clause of the Fifth Amendment to the Constitution;

(b) as repugnant to the Commerce Clause of the Constitution; or

(c) as unconstitutionally extending the power of the Commissioners beyond their territorial jurisdiction;

when the application of such formula results in the taxation by the District of 100% of the net income of a foreign corporation derived from that segment of its business consisting of the manufacture and sale of products without the District to customers within the District, thus

(1) taxing extraterritorial values and assigning to the District values which belong to, and have been properly taxed by, other States;

(2) imposing upon interstate commerce cumulative tax burdens (double taxation) to which local commerce is not subject; and

(3) subjecting to District tax an amount of income out of all reasonable proportion to the business actually "carried on or engaged in" within the District.

II. *Statutory Construction*

Whether the District of Columbia Income and Franchise Tax Act of 1947, which imposes a franchise tax on corporations carrying on business within and without the District, measured by net income "fairly attributable" to District business, permits the adoption by regulation of the District Commissioners of a single-factor sales formula to determine the amount of such taxable income, when the application of such formula subjects to District tax 100% of the net income of a foreign corporation derived from that segment of its business consisting of the manufacture and sale of products without the District to customers within the District, a percentage which is out of all reasonable proportion to the business carried on within the District.

CONSTITUTIONAL PROVISIONS, STATUTES, AND REGULATIONS INVOLVED

Art. I, § 8, cl. 3 of the Constitution of the United States and the Due Process Clause of the Fifth Amendment thereto are set forth in Appendix G-1, p. 86a, *infra*.

The pertinent sections of the District of Columbia Income and Franchise Tax Act of 1947, being §§ 47-1580 and 47-1580a of the D.C. Code 1961, are set forth in Appendix G-2, pp. 86a-88a, *infra*.

Section 10.2-(c)(1)(a) of the Regulations of August 6, 1953 (as relettered by amendment of July 24, 1956) is set forth in Appendix G-3, pp. 88a-89a, *infra*.

STATEMENT OF THE CASE

Petitioner, General Motors Corporation, brought proceedings in the District of Columbia Tax Court for the review of franchise tax deficiencies for the taxable years 1957 and 1958 assessed by respondent, District of Columbia, purportedly pursuant to the District's Income and Franchise Tax Act of 1947 (D.C. Code 1961, §§ 47-1551 *et seq.*); and for refund of the taxes so assessed and paid under protest. (R. 1-37.)

General Motors is a Delaware corporation qualified to do business in the District. (R. 465.) In the taxable years involved it was engaged principally in the manufacture of motor vehicles, parts and accessories therefor. Such manufacture was accomplished entirely outside the District, and largely (as to the products herein involved) in Michigan, Delaware and Maryland. (R. 399-400, 484-485.) Some of such products were sold to customers (retail dealers) whose places of business were in the District, and were shipped to them there. Not only the entire manufacturing activity, but most of the selling activity was carried on without the District. (R. 400-456, 471-483.)

The sales offices were outside the District. Personnel from those offices, none of whom resided in the District, regularly called on customers in the District for promotional purposes and for checking on and assisting in improving their operations. Several small offices were maintained in the District (*e.g.*, a public relations office; a patent office), but they were not directly related to the taxed sales and their presence had no bearing on the assessments. (R. 399-464, 471-477.)

In determining the amount of petitioner's total net income subject to franchise tax in the District, respondent multiplied such total net income by a fraction the numerator of which was the amount of sales by petitioner to customers located in the District and the denominator of which was total sales everywhere. In other words, it determined and taxed the total profit on all sales to customers located in the District (on the assumption that each sale was equally profitable). This is referred to herein as a "single-factor sales formula," in contrast to apportionment formulae which take into account the contribution of capital and labor to the production of income.

The Tax Court made the following *findings of fact*: The segment of petitioner's business which was conducted both within and without the District consisted of the manufacture of motor vehicles and related products without the District and their sale to customers located within the District. The net income from this segment of the business was earned by a series of transactions, including procurement of material, use of property, financing and manufacture in various States and ending with sales to customers located in the District. Finding 5, Appendix A, p. 3a, *infra*. The single-factor sales formula used in determining taxable net income assigned to the District 100% of the net income arising from that segment of the business and was out of all reasonable proportion to the trade or business carried on or engaged in by General Motors in the District. Finding 6, Appendix A, p. 3a, *infra*. A portion of the net income derived from that segment of the business consisting of the manufacture without the District and sale to dealers in the District was taxed in Michigan, Maryland and Delaware, the States of manufacture, pursuant to apportionment formulae provided in their income-based tax laws. Findings 3(a), 3(b), Appendix A, p. 2a, *infra*.

The record overwhelmingly sustains the Tax Court's findings. The testimony shows that petitioner's net income is derived from the totality of its activities, from design and engineering, through procurement of materials, use of plants and other property, management, and selling and other activities, and that the extent of the contribution of each of these elements is measured by its cost and geographically attributable to the places where the costs (property and payroll) are incurred. (R. 45, 48-58, 76-7, 81-3, 90-6, 98-9, 112, 114-5, 117-8, 124-6, 134-7, 142-3, 148-55, 327-8, 349-55, 372-8.) Applying those facts to the stipulated figures (R. 477-481) produced a highly accurate computation of petitioner's income derived from business carried on in the District. (Appendix H, p. 90a, *infra*.) The amounts assessed are approximately thirteen times such income. The single-factor sales formula assigns to the District for tax purposes 100% of the net income derived from that segment of the business culminating in receipts from District customers even though the products were manufactured and sold elsewhere. (R. 154-155, 328, 331-332.) The District's own witnesses testified that taxing 100% of such net income failed to apportion such income as required by the statute. (R. 285-9, 313-22.) Multiple taxation of such net income was established by the Michigan, Maryland and Delaware tax returns and evidence of payment made part of the record. (Pet. Trial Exh. 9-21f.)

The Tax Court held on this record that the single-factor sales formula as applied in the circumstances of this case produced an arbitrary and unreasonable result, violating the apportionment provisions of the Act (D.C. Code 1961, §§ 47-1580, 47-1580a), since it identified, but did not apportion, the income derived from business conducted within and without the District. Thus it invalidated the formula as applied to petitioner and redetermined the tax deficiencies using a three-factor formula of prop-

erty, payroll and sales, each factor receiving equal weight, as the method best suited to determine the portion of petitioner's net income subject to tax. It did not decide the constitutional questions raised. Appendix A, p. 1a, *infra*.

The District appealed the Tax Court decisions to the Court of Appeals for the District of Columbia Circuit. On February 21, 1963, a division of the Court, one judge dissenting, affirmed the Tax Court, Appendix B, p. 42a, *infra*. That Court granted, on April 18, 1963, the District's petition for rehearing *en banc*, and on February 13, 1964, five judges reversed the decisions of the division and of the Tax Court and affirmed the deficiency assessments, deciding the statutory and constitutional questions adversely to petitioner. Four judges dissented (one concurring in part on a procedural matter). Appendix C, p. 46a, *infra*.

Petitioner timely filed on February 25, 1964, a petition for rehearing to modify the judgments of February 13, 1964, which petition was granted on May 7, 1964. The final judgment entered on that day holds that all net income from "District sales" must be assigned to the District for tax purposes, but leaves for subsequent determination what sales are "District sales"—i.e., "fairly attributable" to business carried on in the District. Appendix E and F, pp. 83a, 85a, *infra*. Review by this Court is sought at this time because, in our opinion, regardless of what sales are ultimately found to be "District sales", the taxing of 100% of the income derived from the business culminating therein is both contrary to the statutory direction that such income be apportioned and unconstitutional. A determination of that issue is "fundamental to the further conduct of the case". *United States v. General Motors Corporation*, 323 U.S. 373, 377. The remand for computation would not resolve any of the questions raised in this petition.

BASIS FOR FEDERAL JURISDICTION IN THE LOWER COURTS

These proceedings were commenced by General Motors in the District of Columbia Tax Court under § 47-1593, D.C. Code 1961. The District, pursuant to § 47-2404, D.C. Code 1961, perfected appeals to the Court of Appeals for the District of Columbia Circuit.

REASONS FOR GRANTING THE WRIT

The Court of Appeals has:

(a) erroneously decided an important question of constitutional law with respect to the apportionment for tax purposes of the net income of corporations doing business in more than one jurisdiction, in conflict with applicable decisions of this Court; and

(b) erroneously construed the District of Columbia Income and Franchise Tax Act of 1947 in a manner affecting every taxpayer doing interstate business in the District.

1. Impact of the Decision.

If allowed to stand, this decision will have an important direct effect in the District of Columbia, where at least 48 cases controlled by it are pending before the Tax Court and an unknown number of others are awaiting administrative determination. Of far greater importance, however, is the national impact.

It has recently been estimated by a Congressional subcommittee that no less than 120,000 corporations, ranging from the size of petitioner to small family enterprises, engage in interstate commerce and thus are potentially subject to income taxation in more than one jurisdiction.[1]

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[1] "State Taxation of Interstate Commerce", Report of the Special Subcommittee on State Taxation of Interstate Commerce of the

Since 38 states and 95 municipalities now impose taxes on (or measured by) net income of corporations, and the practice is spreading,[2] the need for a clear outline of constitutional limitations, which can be supplied by this Court alone, is great. This Court has now, in the 1959 decision in *Northwestern States*,[3] made it clear that States may tax the net income of exclusively interstate commerce, *provided it is fairly apportioned.* One result of that decision is greatly to increase the number of taxpayers concerned with the answer to the question of what is fair apportionment.

Although this Court cannot be expected to devise and impose an apportionment formula for uniform application, it can and should prescribe the outer limits of fair apportionment. This case is both a striking illustration of the need for such guidelines and an excellent opportunity, at the most opportune time, to establish them.

The effect of the decision below is to permit the State or city in which all a taxpayer's customers are located to tax the entire net income of the taxpayer, even though the taxpayer's entire operations are elsewhere (nexus assumed). Note the temptation which this offers to exact tribute from the foreigner while subsidizing the domiciliary. Attempts to do just that are a virtual certainty if this decision stands, and appeals to this Court for relief are equally certain. The time to dispose of them is now.

2. The Assessments are Unconstitutional.

Although this Court has several times considered the constitutional restraints upon the formulae which may

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Committee on the Judiciary of the House of Representatives, pursuant to P. L. 86-272, House Report No. 1480, 88th Cong., 2d. Sess. 77, 593 (June 15, 1964).

[2] *Id.*, pp. 99, 447.

[3] *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450.

be applied in apportioning net income, this is the first time the Court has been confronted with a decision in which an appellate court has upheld the constitutionality of an apportionment formula in the face of a square finding by the trier of the facts, based upon a record which "overwhelmingly sustains" such finding,[4] that the percentage of income subjected to tax was "out of all reasonable proportion to the trade or business carried on or engaged in by petitioner within the" taxing jurisdiction.[5]

The District formula (allocating entire net income to the situs of the customer) is wholly incompatible with formulae which have been approved by this Court: *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (apportionment by the State of manufacture according to situs of property); *Bass, Ratcliff & Gretton* v. *State Tax Commission*, 266 U.S. 271 (apportionment by the State of sale according to situs of property); *Butler Bros.* v. *McColgan*, 315 U.S. 501 (apportionment by three-factor formula of property, payroll and sales versus separate accounting); *Spector Motor Service* v. *O'Connor*, 340 U.S. 602 (apportionment by three-factor formula of property, payroll and sales); *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450 (apportionment by three-factor formula of property, payroll and sales).

It is obvious that if the apportionment formulae in those cases were "fair" the allocation in this case cannot be, because it necessarily results in double taxation of income earned in a State employing such an approved formula if sales are made to customers in the District. The Tax Court found *as a fact* that such double taxation existed in this case, because the same income which the District taxed in its entirety had been partially taxed

[4] See dissenting opinion of Judges Danaher, Miller, and Bastian in the Court of Appeals, App. C, p. 80a, *infra*.

[5] Finding No. 6, App. A, p. 3a, *infra*.

by Michigan, Maryland and Delaware pursuant to formulae of the type approved in *Butler Bros.*, *Spector* and *Northwestern States.*[6]

The Commerce Clause prohibits the imposition upon interstate commerce of such cumulative burdens to which intrastate business is not subject.[7] *H. P. Hood & Sons, Inc.* v. *DuMond*, 336 U.S. 525, 538-539; *Western Livestock* v. *Bureau of Revenue*, 303 U.S. 250, 255-256; *Michigan-Wisconsin Pipe Line Co.* v. *Calvert*, 347 U.S. 157, 170; *J. D. Adams Mfg. Co.* v. *Storen*, 304 U.S. 307, 311-312; *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 458, 462-463.

The assessments also attempt to reach values not within the territorial jurisdiction of the District. The Tax Court found *as a fact* that the income which the District taxed in its entirety was earned by a series of transactions, most of which took place outside the District,[8] and further found *as a fact* that the amount of income so assessed was out of all reasonable proportion to the business done in the District.[9] As the Due Process Clause of the Fourteenth Amendment restrains States from taxing values not within their jurisdiction, *Wallace* v. *Hines*, 253 U.S. 66,70, and prohibits the use of any apportionment or allocation which, either intrinsically or as applied in particular circumstances, taxes "a percentage of income out of all appropriate proportion to the business transacted . . . in that State", *Hans Rees' Sons* v. *North*

[6] Finding 3(b), App. A, p. 2a, *infra*.

[7] The Commerce Clause, being a grant of power to Congress, does not circumscribe Congressional power to legislate for the District, *Neild* v. *District of Columbia*, 110 F.2d 246 (D.C. Cir.), but it does restrain the District Commissioners. *Stoutenburgh* v. *Hennick*, 129 U.S. 141, 148; *District of Columbia* v. *John R. Thompson Co.*, 346 U.S. 100, 107. The objectionable formula was not prescribed by Congress, which merely directed a fair apportionment, but by the Commissioners.

[8] Finding 5, App. A, p. 3a, *infra*.

[9] Finding 6, App. A, p. 3a, *infra*.

Carolina, 283 U.S. 123, 135, so does the Due Process Clause of the Fifth Amendment restrain Congress, and *a fortiori*, the Commissioners, in legislating for the District. *Bolling* v. *Sharpe*, 347 U.S. 497, 499; *Hamilton National Bank* v. *District of Columbia*, 176 F.2d 624 (D.C. Cir.), *cert. den.*, 338 U.S. 891.

Furthermore, even apart from the specific constitutional protection of "due process", a State may not reach transactions outside its territoral jurisdiction. *New York, Lake Erie & Western R.R. Co.* v. *Pennsylvania*, 153 U.S. 628, 646; *Miller Bros. Co.* v. *Maryland*, 347 U.S. 340, 342. The District Commissioners have no greater power.

Double Taxation Was Established

The Court of Appeals apparently recognizes that double taxation of the income of interstate commerce, solely because it is interstate, unconstitutionally imposes upon interstate commerce cumulative burdens not borne by intrastate commerce. It says, however, that petitioner has "failed to" "show by specific evidence that 'double taxation' would result from the application of the District's formula".[10] In doing so, it ignores the combined effect of findings of fact that: The vehicles sold to District customers were manufactured in Michigan, Maryland and Delaware;[11] petitioner's income related to sales to customers in the District was attributable in part to such manufacture;[12] tax was (properly) paid to those States with respect to a portion, determined by formulae of property, payroll and sales, of income derived from such manufacture and subsequent sale;[13] and the District's assessments, based on sales alone, taxed 100% of such income.[14]

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[10] Opinion, App. C, p. 72a, *infra*.

[11] Finding 2, App. A, p. 1a, *infra*.

[12] Finding 5, App. A, p. 3a, *infra*.

[13] Finding 3, App. A, p. 2a, *infra*.

[14] Finding 6, App. A, p. 3a, *infra*.

Those findings, which are undisputed, should have led the Court of Appeals inescapably to the conclusion that double taxation had in fact been established and that it was attributable to the overreaching of the District's single factor destination sales formula.

While the Tax Court thus found that part of the *same* income which the District assessed in its entirety had been taxed elsewhere, and no contention was made by respondent that such finding was not based on ample evidence, the Court of Appeals still says that there was no showing of double taxation and that "the company has produced only a hypothetical situation to prove its case". Simplified hypothetical figures were indeed used in the brief to show *how* the double taxation resulted necessarily from the District's improper "formula", but the *fact* of double taxation found by the Tax Court was demonstrated by evidence, not by hypothesis.

What the hypothetical argument demonstrated was that the double taxation was no merely minor overlap, but a really substantial duplication. Nearly all of petitioner's relevant income-producing facilities and activities were in other States which, using three-factor formulae, attributed almost two-thirds of the income to the capital and labor employed in those States, and one-third to the sale.[15] Inevitably, when the District used a single-factor sales formula which attributes three-thirds of the income to the sale, and ignored the contribution of the activities in the producing States, approximately two-thirds of the income was taxed twice.[16] Such duplica-

[15] To the extent that the property and payroll were present in the jurisdiction where the sale occurred, the proportions stated would vary. But those factors were minimal here, as the stipulated facts summarized in Appendix H, p. 90a, *infra*, demonstrate.

[16] Petitioner's "hypothetical argument" is quoted by the court, App. C, p. 73a, *infra*. A comparable "simplified example" was found "commendable" by this Court in clarifying the isues in *United States* v. *Consolidated Edison Co.*, 366 U.S. 380, 382. Our example was used for that purpose, and was based on the evidence, not offered as a substitute for evidence.

tion was grossly discriminatory against interstate commerce, since another corporation, both manufacturing and selling in the District, would be taxed on only 100% of its income, not on 166⅔%.

Grossly Disproportionate Taxation Was Established

The Tax Court found *as a fact* that the *taxed* income was earned by a series of transactions—manufacturing, etc.—which took place outside the District.[17] Then it continued:[18]

> "The method used by the assessing authority of the District attributed to the District 100 per centum of the net income derived by the petitoner from that segment of its business which consisted of the manfacture without, and the sale of the products within the District. The percentage thus determined was out of all reasonable proportion to the trade or business carried on or engaged in by petitioner within the District."

Thus the Tax Court has set up a perfect syllogism:

(a) the income arising from business culminating in sales to District customers was in part earned by activities outside the District;

(b) the District formula taxed 100% of such income;

(c) that percentage was grossly disproportionate to the activities in the District.

The Court of Appeals does not deny the factual correctness of the premises (a) and (b), findings which were not only based upon ample evidence, including the testimony of the District's own witnesses (R. 285-9, 313-22), but which, as to (b), are demonstrable from the structure of the regulation (as applied) itself. Instead, it reasoned

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[17] Finding 5, App. A, p. 3a, *infra*.

[18] Finding 6, App. A, p. 3a, *infra*.

that because the Tax Court made the legal error of thinking that only the segment income was to be apportioned rather than the entire income from all operations, whether or not touching the District, (b) above was vitiated, and hence (c) must fall. The *non-sequitur* is obvious. Actually, both petitioner and the Tax Court recognized from the beginning that the entire income was to be apportioned, as shown in the Tax Court's computations (App. A, p. 23a, *infra*). Aside from that, however, it is clear that the syllogism moves from fact to fact, without the application of any view of the law, right or wrong, and that the conclusion (c) is inescapable. It is a finding of fact binding on the Court of Appeals.

The statement of the Court of Appeals that the finding is "irrelevant" [19] flies squarely in the face of this Court's decision in *Hans Rees' Sons* v. *North Carolina*, 283 U.S. 123, 135, where just such a finding as the Tax Court made here was made the basis for invalidating an apportionment formula as applied to the taxpayer before the Court. The majority below sought to distinguish *Hans Rees' Sons* on the ground that the proof "must be much more detailed and specific than that adduced here," and that petitioner "did not undertake to show that the District of Columbia operations accounted for a specific percentage of General Motors' total income, which percentage could, as in *Hans Rees' Sons*, be compared with that taxed under the single-factor formula . . . Nowhere in the record do there appear specific percentages of the kind accepted by the Supreme Court in *Hans Rees' Sons*." [20] Precision in assign-

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[19] App. C. p. 66a, *infra*.

[20] App. C, pp. 68a, 70a, *infra*. Petitioner had been forewarned by the Court of Appeals decision in *Smoot Sand & Gravel Co.* v. *District of Columbia*, 261 F.2d 758 (D.C. Cir.), *cert. den.*, 359 U.S. 968, in which the taxpayer sought protection under the doctrine of *Hans Rees' Sons*. *Smoot* showed that all its "manufacturing" operations took place in Virginia, and offered measures by which to

ing an exact percentage of income to its source, however, is a recognized impossibility. It was not present in *Hans Rees' Sons* (where alternative analyses ascribed from 17 to 21.7% of income to the taxing jurisdiction), and this Court declared that it was *not necessary* "to determine as a matter of fact the precise part of the income which should be regarded as attributable to the business conducted in North Carolina," in order to determine that the amount taxed was excessive. (pp. 134-135 of 283 U.S.)

In *Hans Rees' Sons*, the evidence by which the reasonableness of the apportionment was tested was an application of separate accounting, which was feasible in the case of a simple business dealing in a single fungible product. But in a complex unitary business, arriving at a meaningful apportionment of income by separate accounting is not merely infeasible; it has been rejected as an *impermissible* means of testing the validity of an apportionment formula. *Butler Bros.* v. *McColgan*, 315 U.S. 501, 506-9. To hold that no evidence other than the kind presented in *Hans Rees' Sons* can be used to test a formula would nullify the constitutional protection against arbitrary and excessive apportionment in the case of all but the simplest businesses in our complex society.

Petitioner presented testimony of acknowledged experts in economic analysis, establishing that petitioner's net income is created by and derived from the totality of its activities and efforts as an integrated manufacturing and

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determine what part of its income was attributable thereto. The court thought the measures were irrelevant because it had not been shown in principle that manufacturing contributed anything at all to the production of income. Apparently, Smoot had not thought it necessary to prove that point, in view of the pronouncements of this Court that income is the product of capital and labor, a proposition which seems self-evident. However, since it was not self-evident to the Court of Appeals, we undertook to, and did, prove it by expert testimony, and then went on to prove similarly the best ways of measuring those contributions and attributing them geographically. The precise figures were stipulated.

selling business; that the place where such income is produced is where the factors of production are employed to earn it; and that cost is the best measure of the contribution of such factors to the production of income. (R. 45, 48-58, 76-7, 81-3, 90-6, 98-9, 112, 114-5, 117-8, 124-6, 134-7, 142-3, 148-55, 327-8, 349-55, 372-8.) The stipulated facts (which are summarized in tabular form in Appendix H, p. 90a, *infra*) established that the factors of production, capital and labor, even with respect to the products sold to customers located in the District, were employed almost exclusively in other jurisdictions, and that the allocation of income based exclusively on the customers' location attributed to the District many times the amount of income properly attributable to the factors of production applied therein. (R. 477-481.)

The Tax Court found that the income taxed by the District was largely attributable to activities elsewhere. Then, relying upon the expert testimony and stipulated facts, it measured the contributions of capital and labor, and determined their geographical locations with far more precision than was possible in *Hans Rees' Sons*—in the District, the averages being .0348% in 1957 and .0366% in 1958.[21] Furthermore, when contrasted with the sales ratios on which the tax was based (.3930% for 1957 and .4875% for 1958), they show a far greater disproportion than in *Hans Rees' Sons* between the assessments and the income locally derived.

This Court has repeatedly expressed itself in accord with the view of the expert witnesses, in holding that "The profits of the corporation were largely earned by a series of transactions beginning with manufacture . . . and ending with sale . . . ." *Underwood Typewriter Co.*

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[21] For 1957, .0218% for property and .0477% for payroll in the District. For 1958, .0207% for property and .0524% for payroll. The derivation of those figures, which the Tax Court determined (App. A, pp. 26a, 27a, *infra*), is shown in App. H, p. 90a, *infra*.

v. *Chamberlain*, 254 U.S. 113, 120; *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U.S. 271, 282; *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123. The majority below recognized such agreement in theory, but declared that "The theory proved the case in *Underwood* no better than it does here." [22]

In so stating, the court below missed the point of the *Underwood* decision. The apportionment formula in *Underwood*, as in *Bass* and *Rees*, was based on a single factor of *property*. A formula based on only one of the factors of production, and ignoring the rest, may achieve a permissible rough approximation in a particular case if the disregarded elements exist in the jurisdiction in proportions not too far different from the factor which is considered.[23] In *Underwood*, in the absence of evidence to the contrary (such as was presented in *Rees*), the Court sustained the single-factor property formula as one which, "for all that appears in this record, reached, and was meant to reach, only the profits earned within this State" (254 U.S. at 121).

In contrast, the single-factor *sales* formula reaches, and is designed to reach, the *entire* net income connected with every sale into the District, including profits earned by the application of capital and services in other jurisdictions.

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[22] App. C, p. 69a, *infra*.

[23] The Court of Appeals cites *Ford Motor Co.* v. *Beauchamp*, 308 U.S. 331, *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U.S. 271, and *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113, for the proposition "that a single-factor formula is not inherently arbitrary or unreasonable". That is true, provided that the factor is selected and applied appropriately in the individual case. It is "arbitrary and unreasonable" if in a particular case it produces a seriously unjust result. *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123. It is worth noting that the formulae involved in *Ford Motor*, *Bass, Ratcliff & Gretton*, *Underwood Typewriter*, and *Hans Rees'* if applied in this case would reduce General Motors' tax liability to the District near zero and that the formula involved in *Butler Bros.*, *Spector*, and *Northwestern States* would have reached a result substantially similar to that reached by the Tax Court.

The so-called "formula" does not apportion income at all, but merely identifies "the net profits from the entire transaction," a step which should be merely preliminary to apportioning such profits.[24] In sustaining the tax in the face of the record and the findings, the majority of the Court of Appeals has placed itself in direct conflict with this Court's declaration that the *Underwood* and *Bass* decisions "are not authority for the conclusion that where a corporation manufactures in one State and sells in another, the net profits of the entire transaction, as a unitary enterprise, may be attributed, regardless of evidence, to either State." *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123, 132. The conflict of decisions is not lessened by the fact that the nature of the evidence on which the trial court's finding was based differed from that presented in *Hans Rees' Sons.*

3. The Assessments Are Contrary to the Statute.

Although "the importance of the problem to the administration of local taxes" [25] was sufficient to move the Court of Appeals to grant a rehearing *en banc*,[26] we recognize that this Court ordinarily respects the construction of District statutes adopted by the Court of Appeals. In this instance, however, the question of statutory construction lies at the base of the constitutional issues.

The District of Columbia Income and Franchise Tax Act of 1947 (D.C. Code 1961 § 47-1551 *et seq.*) imposes a "franchise tax upon every corporation . . . for the privilege of carrying on or engaging in any trade or business within the District", measured by "that portion of the

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[24] Respondent's witness Watson testified that, as an economic matter, "the net income from any one batch of sales . . . is proportionate to the net income from any other batch of sales." (R. 270). The single-factor formula, in effect, applies an average rate of profit to all sales and thereby determines the *total profit* on all business culminating in sales to District customers.

[25] The importance is national, as well. Point 1, *supra*.

[26] App. C, p. 46a, *infra*.

net income of the corporation . . . as is fairly attributable to any trade or business carried on or engaged in within the District." If the business "is carried on or engaged in both within and without the District, the net income derived therefrom shall . . . be deemed to be income from sources within and without the District," and "the portion thereof subject to tax . . . shall be determined under . . . regulations prescribed by the Commissioners."[27]

There can be no complaint about the statute itself. The fault lies in the exercise of that delegation, both in the regulation itself and in its application. The regulation assigns to the District that percentage of the corporation's net income that "the District sales . . . bear to the total sales made everywhere . . . 'District sales' shall mean all sales to District customers the income from which is fairly attributable to the trade or business carried on or engaged in within the District . . ."[28] In applying that regulation, the District construed "District sales" to mean all sales to customers located in the District, regardless of all other considerations. This, in tax parlance, is known as the "destination sales" test.[29] It assumes, as some of the District's witnesses testified, that net income is "fairly attributable" in its entirety to the customer and his location, and in no part to manufacturing and selling activities which take place elsewhere.

The Tax Court sustained the petitioner's position that this test, as applied, was not authorized by the statute, since it merely *identified* the amount of net income derived from that segment of petitioner's business conducted both

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[27] D. C. Code 1961 § 47-1580, 1580a, App. G, p. 85a, *infra*. Part IV of the Tax Court's opinion, App. A, pp. 13a-17a, *infra*, contains a helpful discussion of the history of the statute.

[28] App. G, p. 88a, *infra*.

[29] It does not reach actual destination with any certainty—merely the point to which the goods are shipped in the first instance. A General Motors dealer in the District may sell a car to a customer in Maryland, or may transfer one to a branch in Virginia and sell it there.

within and without the District, segregating it from income derived from petitioner's business conducted wholly without the District. It did not follow the statutory mandate that such income be deemed to be from sources both within and without the District (as the District's expert witnesses admitted),[30] and it did not *apportion* it. Instead, it *allocated* it 100% to the District, as the Tax Court specifically found.[31]

The majority of the Court of Appeals held[32] that the assessments satisfied the statutory requirement of an apportionment because they divided the *entire* net income from all sources into taxable and nontaxable portions. The fact that the only segment of petitioner's income that had even a partial connection with District activities was taxed in its entirety, and not apportioned, was dismissed as irrelevant.

The Tax Court had pointed out the fallacy of this reasoning and emphasized it by noting that, if a corporation's entire manufacturing operation took place in Maryland and its entire product was sold in the District, the approach used in these assessments would assign 100% of the net income to the District, in direct conflict with the statutory command that such income be deemed to be derived from sources both within and without the District

[30] R. 285-289, 313-322.

[31] Finding 6, App. A, p. 3a, *infra*. Another respect in which the District's formula and assessments violate the statute is that they fail to tax at all other income which the statute directs shall be taxed. No income whatever is attributed to the offices in the District whose activities (patents, public relations, etc.) are unrelated to the taxed transactions. Such offices make some contributions to the entire income of the corporation, which income the statute deems to be derived partly from within the District and partly from without. The assessments put it all without. It does not matter that the deviations from the statute are in opposite directions and thus tend to offset. Each is a flagrant violation and the offset is very minor.

[32] Opinion, Court of Appeals, App. C, pp. 62a-66a, *infra*.

and apportioned accordingly.[33] Assume, for example, that the corporation's net income from such business in 1957 is $100,000. The statute clearly requires that such income be deemed to be derived in part from Maryland and in part from the District, and only that part "fairly attributable" to the District may be taxed there. Any regulation or assessment which says that 100% is "fairly attributable" to the District is obviously wrong, and presumably the Court of Appeals majority would have to agree that an apportionment had not been made as required by the statute. If by an apportionment formula, or separate accounting, or some other acceptable method it is determined that the correct portion is $25,000, the District is entitled to tax that much and Maryland the balance.

Now assume that in 1958 the corporation establishes a new factory in Pennsylvania, manufacturing a different product and selling it entirely to Pennsylvania customers, earning another $100,000 net income, while the Maryland-District business remains the same. It should be clear that income taxable in the District remains at $25,000, while Maryland has $75,000 and Pennsylvania $100,000. But the Court of Appeals would say that because the Pennsylvania income is not taxed by the District, it may now tax 100% of the Maryland-District income.

The confusion and conflict within the Court of Appeals is well illustrated by contrasting the decision below with that in *Broadcasting Publications, Inc.* v. *District of Columbia*, 313 F.2d 554 (D.C. Cir.), in which rehearing *en banc* was denied on January 25, 1963, while the present case was under submission. *Broadcasting Publications* involved a periodical published in the District, with 97% of its circulation in other jurisdictions. The Tax Court, relying on *District of Columbia* v. *Evening Star Newspaper Co.*, 273 F.2d 95 (D.C. Cir.), divided the income

[33] Opinion, Tax Court, App. A, p. 10a, *infra*.

according to the place of sale. But the Court of Appeals, minimizing the importance of the location of the customer, stressed the productive operations which "are the main elements . . . from which a formula of allocation must be derived," and the need to identify the "function which fairly reflects the geographical sources of income." (p. 559 of 313 F.2d.) Accordingly, the Court of Appeals concluded that the entire income of the taxpayer was taxable in the District, where almost all its productive activities and facilities were concentrated. A comparison of the facts of the cases, shows that *every consideration which brought Broadcasting Publications into the District puts General Motors outside the District.* If *Broadcasting Publications* is good law, General Motors cannot be taxed by the District at all.

General Motors does not, however, contend for complete exemption from District tax. It is satisfied with the disposition of the case by the Tax Court which, having found that there was no valid and applicable regulation prescribing an apportionment formula, exercised its own power to adopt the formula it determined to be "best suited" in the circumstances of the case. Its power to do so was established by *District of Columbia* v. *Gallant, Inc.*, 290 F.2d 745, 748 (D.C. Cir.). The three-factor formula which the Tax Court adopted, the suitability of which is fully supported by the record, attributed to the District approximately 39% of the profit derived from sales to District customers of products manufactured and sold elsewhere.[34]

CONCLUSION

Ten judges have considered this case. Five of them have accepted respondent's position. Five others, includ-

[34] Appendix A, pp. 26a, 27a, *infra*. The 39% figure is arrived at by comparing the percentage of net income actually taxed with that derived from the sales ratio, alone, which reflects the *total* profit on all sales to District customers.

ing the Tax Court judge who heard the evidence, have agreed with petitioner. Their view is forcefully expressed in the dissenting opinions below:

> "It does not do for the majority simply to say that as to *some* corporations and in *some* situations a single-factor formula may validily be utilized. Nor is it an answer to this taxpayer's contentions that the records in *some* cases have shown no more than that the single-factor formula has not resulted inequitably. We are here dealing with a record which overwhelmingly sustains the Tax Court's findings. I deem its conclusion inescapable that the single-factor sales formula utilized by the Assessor was here proved to be arbitrary and inequitable in its result . . . A study of the findings . . . necessarily impels a rejection of the single-factor sales formula *as here applied*." [35]
>
> * * * *
>
> "I join with the dissent in viewing the Assessor's action as arbitrary and I would go further and hold that it is legally arbitrary and capricious . . ." [36]

For the foregoing reasons, the petition for a writ of certiorari in this case should be granted.

Respectfully submitted,

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[35] Judge Danaher, with whom Judges Miller and Bastian joined. App. C, pp. 80a, 81a, *infra*.

[36] Judge Burger, App. C, p. 81a, *infra*.

APPENDIX

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APPENDIX A

DISTRICT OF COLUMBIA TAX COURT

Findings of Fact and Opinion

[as filed January 29, 1962, with amendments of February 27, 1962 incorporated]

These two cases have been consolidated for hearing and disposition. They involve the same questions of taxation for the calendar years 1957 and 1958. The assessing authority of the District of Columbia assessed the petitioner substantial franchise taxes. The petitioner here appeals from the assessments and claims that they are invalid. The respondent insists that the assessments are proper and justified under Title X of the District of Columbia Income and Franchise Tax Act of 1947.[1]

Findings of Fact

Most of the facts are stipulated and, together with exhibits, are found as stipulated.

The Court finds additional facts for the taxable years involved as follows:

1. The petitioner had business establishments in 38 states and the District of Columbia. The principal office or headquarters of the petitioner was in Detroit, Michigan. There was an executive office in New York City in which were located the financial executives of the petitioner.

2. (a) The factories of the petitioner were located principally in the states of Michigan, Ohio, Illinois, Indiana, New York, New Jersey, Delaware, Maryland, Mis-

[1] Title X of Chapter 15 (Sections 47-1580 and 47-1580a), D. C. Code, 1951 Edition.

souri, California and Georgia. There was no factory or assembly plant of the petitioner in the District of Columbia.

(b) Approximately fifty per centum of petitioner's physical properties, including factories, equipment and inventories, and payroll amounts were located or paid in Michigan.

(c) All Cadillac automobiles and all heavy trucks of the petitioner's GMC and Coach Divisions were manufactured in Michigan. In addition, many component parts of automobiles and quantities of Buick, Oldsmobile and Pontiac automobiles were manufactured in that state.

(d) At the petitioner's factory or plant in Maryland there were assembled Chevrolet automobiles for shipment to the District of Columbia and the surrounding states.

(e) At the petitioner's factory or plant in Delaware there were assembled Buick, Oldsmobile and Pontiac automobiles for shipment to the District of Columbia and the surrounding states.

3. (a) The petitioner in accordance with the statutes of the respective states filed income tax returns and paid income taxes for the taxable years involved as follows:

Year	State	Amount
1958	Delaware	$ 127,844.95
1957	Maryland	510,792.31
1958	Maryland	271,425.75
1957	Michigan	8,955,799.55
1958	Michigan	6,940,309.50

(b) A portion of the net income of petitioner derived from the segment of the petitioner's business consisting of the manufacture of products without, and sale within the District of Columbia was taxed by the above mentioned

states, pursuant to apportionment formulas (with factors of property, payroll and sales), as provided by their laws.

4. At a conference between the representatives of the petitioner and of the Finance Officer of the District of Columbia, after notice of the latter's intention to assess the deficiencies here involved, the representatives of the petitioner protested the contemplated assessment and stated that the apportionment made was out of all proportion to the business carried on in the District by the petitioner; and that the formula used was basically unfair because it did not take into consideration or employ factors which were important in the production of income from manufacturing; and suggested that factors other than sales should be employed in apportioning the income of the petitioner and suggested that the property and payroll factors should be considered.

5. The segment of petitioner's business which was conducted both within and without the District of Columbia consisted of the manufacture of a certain number of automobiles and kindred products without the District and the sale thereof to customers within the District. The net income from this segment of petitioner's business was earned by a series of transactions beginning with the manufacture of products in several states and ending with the sale to customers in the District. While the net income was not realized until sale, it was earned in part by manufacture of the products sold, including in addition to actual manufacture, procurement of material, financing, use of property and administration.

6. The method used by the assessing authority of the District attributed to the District 100 per centum of the net income derived by the petitioner from that segment of its business which consisted of the manufacture without, and sale of the products within the District. The percentage thus determined was out of all reasonable propor-

tion to the trade or business carried on or engaged in by petitioner within the District.

Opinion

The assessing authority of the District of Columbia assessed the petitioning taxpayer deficiencies in franchise tax and interest as follows: for the calendar year 1957 a deficiency of $268,585.40, plus interest of $35,879.40 or a total of $303,964.80; and for the calendar year 1958 a deficiency of $167,468.44, plus interest of $11,860.89 or a total of $179,329.33. The total amount of both deficiencies, $483,294.13, was paid by the petitioner. These appeals followed. The petitioner claims that the deficiencies and interest in their entirety were erroneously assessed. On the other hand, the respondent contends that they were validly assessed.

For the reasons hereafter stated the Court holds that deficiencies and interest for the two taxable years in the total amount of $317,049.83, were erroneously assessed against, and collected from the petitioner.

Before stating the reasons for the above holding, the Court will consider and dispose of the constitutional questions raised by the petitioner to the extent that it is empowered so to do.

I

CONSTITUTIONAL QUESTIONS

The petitioner has raised three constitutional questions, namely, that in violation of the Constitution (a) the application of the formula results in the taxation by the District of Columbia of values without its borders or taxing jurisdiction, (b) the provision of the statute which exempts or relieves from taxation those corporations or unincorporated businesses which have no office, warehouse or place of business in the District, while imposing a tax

on those who do have an office, warehouse or place of business in the District is unconstitutionally discriminatory, and (c) the attributing to the District of Columbia 100 per centum of the net income of the petitioner derived from that segment of its business, which consisted of the manufacture of products without, and sale thereof within the District, resulted in a tax out of all reasonable proportion to its business carried on or engaged in within the District. The Court does not believe it can decide those questions because of the muddled condition of the status of the Court, that is to say, whether it is a court or an administrative agency.

It is clear that Congress attempted to make the Board of Tax Appeals a court, or, at least, take away its administrative function as "*a constituent member of the assessing authority*" by the Act of July 10, 1952, (see third paragraph of Section 47-2402, D. C. Code, 1961 Edition). Such attempt, however, has been held to be abortive.

In *Hosmer* v. *District of Columbia*, 77 U. S. App. D.C. 295, 135 F. 2d 654, 71 W.L.R. 932, Judge Prettyman held that the then Board of Tax Appeals was not a court, but "*a constituent member of the assessing authority*". He held the same in *Hamilton National Bank* v. *District of Columbia*, 85 U.S. App. D.C. 109, 176 F.2d 624, 77 W.L.R. 1102. After those two decisions Congress attempted, at least, to negative or correct the effect of those decisions by providing in the Act of July 10, 1952, making the Board of Tax Appeals the "District of Columbia Tax Court", that "*the said District of Columbia Tax Court shall not be deemed or held to be a constituent member of the assessing or taxing authority of the District of Columbia*". In a recent case, *District of Columbia* v. *Brady*, 109 U.S. App. D.C. 324, 288 F. 2d 108, Judge Prettyman, however, held as follows:

"Moreover, under the Code, the ultimate exhaustion of the *administrative remedy*, *i.e.*, a decision by the Tax Court, an 'independent agency' in the District Government, or indeed even the filing of an appeal with that Court, precludes the taxpayer from filing suit under his common-law remedy. If the exhaustion of the *administrative remedy* is a bar to a common-law action *a fortiori* it can in no sense be a condition precedent to such a suit.

"We conclude that Dr. Brady's failure to exhaust his administrative remedy did not preclude his bringing action in the District Court.[2]"

The Tax Court of the United States is by the organic Act, a designated administrative agency.[3] In several cases in that Court it was held that it could decide constitutional questions, although serious doubts about that function have been expressed by some of the judges of that Court. This Court is, however, uncertain as to its power to decide a constitutional question and believes that until the matter is more clearly or definitely settled by the United States Court of Appeals or by a declaratory act of Congress, it should not decide the questions, but merely note, as it here does, that the constitutional questions were here raised. The Court, therefore, will decide the other issues presented under the law as it exists.

II

The Basis for Taxation

These cases involve franchise taxes imposed by Section 47-1571a[4] of the Code, which provides as follows:

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[2] It is interesting to note that the same result would have occurred from a holding that the Tax Court was a court and not an administrative agency.

[3] Actually it is a court. There is, and has been for sometime, a movement to have it declared to be a Federal Court.

[4] Section 2 of Title VII, D. C. Income and Franchise Tax Act of 1947.

"For the privilege of carrying on or engaging in any trade or business within the District and receiving income from sources within the District, there is hereby levied for each taxable year a tax at the rate of 5 per centum upon the taxable income of every corporation, whether domestic or foreign."

The question which the Court must answer is: what is the portion of the petitioner's net income that was fairly attributable to the trade or business carried on by it within the District of Columbia during the taxable years involved, 1957 and 1958, and other net income from sources within the District—within the meaning of that part of Section 47-1580[5] reading as follows:

"* * *. The measure of the franchise tax shall be that portion of the net income of the corporation * * * as is fairly attributable to any trade or business carried on or engaged in within the District and such[6] other net income as is derived from sources within the District; * * *."

The question presented in these cases relates solely to that segment of the petitioner's business which involves the manufacture of a certain number of automobiles and kindred products outside the District of Columbia and the sale thereof to customers within the District. To use the language of the many regulations, the trade or business contemplated by the Act is "the *manufacture and sale* or *purchase and sale* of tangible personal property". The Commissioners have correctly interpreted the term "trade or business" to include a combination of either "manufacture" *and* "sale" or of "purchase" *and* "sale". Otherwise, the regulations would have read "manufacture, purchase or sale". (See, among others, Section 10-2(c)(1)

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[5] Section 1 of Title X, ibid.

[6] The word "such", apparently was ineptly inserted. It has no meaning or significance.

(a), Regulations of August 6, 1953.) The regulations in the respect indicated are consonant with the legally established fact that, "income may be defined as the gain derived from capital, from labor, or from both combined" *Strattons Independence, Ltd.* v. *Howbert*, 231 U.S. 399, 415, 58 L. Ed. 285, 34 S. Ct. 136; *Doyle* v. *Mitchell Bros. Co.*, 247 U.S. 179, 185, 62 L. Ed. 1054, 38 S. Ct. 467; *Eisner* v. *Macomber*, 252 U.S. 189, 207, 64 L.Ed. 521, 40 S. Ct. 189. (And we might add "enterprise".) The cases, *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113, 65 L. Ed. 165, 41 S. Ct. 45 and *Bass, Ratcliff and Gretton, Ltd.* v. *State Tax Com.*, 266 U.S. 271, 69 L. Ed. 282, 45 S. Ct. 82, have frequently been cited to support one factor formulas, and in that connection they will be discussed with other similar cases in a later portion of this opinion. At this point they are cited to show that the "trade or business" with which we are here concerned includes both the manufacturing as well as the selling of the merchandise involved; that the net income therefrom is earned by both activities;[7] and that, while net income is not "*realized*" until sale, it is earned in part by the manufacture of the article sold. In the *Underwood Typewriter Co.*, case (254 U.S. at page 120) is the following:

> "The profits of the corporation[8] were largely earned by a series of transactions beginning with manufacturing in Connecticut and ending with sale in other states."

Likewise in the *Bass, Ratcliff & Gretton* case (266 U.S. at page 282) we find this:

> "So in the present case we are of opinion that as the Company carried on the unitary business of manufacturing and selling ale, in which its profits were *earned* by a series of transactions beginning

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[7] Together, of course, with administrative activities.

[8] Similar to the petitioner herein.

with the manufacture in England and ending in sales in New York and other places—the process of manufacturing *resulting* in no profit until it ends in sale, etc." (Emphasis supplied.)

And as the Supreme Court said in *Hans Rees' Sons* v. *North Carolina*, 283 U.S. 123, 75 L. Ed. 879, 51 S. Ct. 385:

> "Undoubtedly the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits."

III

Regulation and Formula Must Comply With Law

At the outset it should be pointed out that, *legally*, any formula or method for the apportionment or determination of net income taxable by the District must, in respect of multistate businesses, accord with that part of Section 47-1580a[9] of the Code, which is in this language:

> "* * *. If the trade or business of any corporation * * * is carried on or engaged in both within and without the District, the net income derived therefrom shall, for the purposes of this article be deemed to be income from sources *within* and *without* the District. * * *." (Emphasis supplied.)

In *McCeney* v. *District of Columbia*,[10] 97 U.S. App. D.C. 282, 285, 230 F. 2d 832, 84 W.L.R. 625, Judge Washington, commenting on the failure of the Commissioners to follow the statute in promulgating regulations, said:

> "Section 47-1601 is explicit that the tax is to be paid on the 'market value' of the interest involved.

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[9] Section 2 of Title X, District of Columbia Income and Franchise Tax Act of 1947.

[10] Involved an inheritance tax.

> This requires, we think, that the actual market value of the interest be determined as nearly as possible. Although Section 47-1607 provides that the value of remainder interest is to be determined by subtracting from the value of the property the value of the life interests, determined in such manner as the Commissioners' regulations prescribe, *this does not authorize the Commissioners to adopt regulations which result in disregarding the directive of the statute to tax only the market value of the interest. It is axiomatic that administrative rules must be consistent with the statute under which they are promulgated.*" (Emphasis supplied.)

See also: *Manhattan General Equipment Co.* v. *Commissioner*, 297 U.S. 129, 134, 80 L. Ed. 528, 56 S. Ct. 397; *Addison* v. *Holly Hill Fruit Products, Inc.*, 322 U.S. 607, 616, 88 L.Ed. 1488, 64 S.Ct. 1215; *Thompson* v. *Amalgamated Casualty Ins. Co.*, 207 F. 2d 214, 220.

Any formula or method which does not conform to, or comply with the plain and unambiguous directive or mandate of the law is, therefore, not legally permissible. For instance, if a corporation manufactures its products at its only plant in Maryland and sells them in the District, a formula with sales as the *sole* factor would be illegal, because under it the entire net income would be assigned to, or deemed to be from sources within the District. Likewise, if property be the sole factor, the formula would be legally improper, because all of the net income would be thereunder assigned to, or deemed to be from sources in Maryland.

It is interesting to note that, if the taxpayer has its office, manufacturing plant or other principal place of business in the District and sells some of its products or performs some of its services without as well as within the District, a formula with one factor of sales only does not necessarily violate the *letter* of the provision of the law that the income must be deemed to be from sources

both within and without the District. Examples of that result are *District of Columbia* v. *Southern Railway Co.*, 107 U.S. App. D.C. 285, 277 F. 2d 84, 88 W.L.R. 277; *District of Columbia* v. *Evening Star Newspaper Co.*, 106 U.S. App. D.C. 360, 273 F. 2d 95, 87 W.L.R. 1371; and *Thompson's Dairy, Inc.* v. *District of Columbia*, D.C.T.C., Docket Nos. 1731 and 1733, Opinion No. 988. In those cases a one factor formula was used, but its use resulted in loss of revenue to the District to which it was economically entitled from the use by the taxpayers of property and administrative services within the District. A formula with the factors of property, payroll and sales would have saved that revenue, which no doubt, is why the Finance Officer of the District has repeatedly requested and urged the Commissioners to adopt the three factor formula for consistent use, that is to say, for the taxation of both resident and nonresident taxpayers.[11]

It should, moreover, be observed at this point that the provision for regulations apply in the statute to instances only where the net income of the taxpayer is "deemed to be income from sources within and without the District". Section 47-1580a of the Code, in part, provides:

> "Where the net income of a corporation or unincorporated business is derived from sources both within and without the District,[12] the portion thereof subject to tax under this article *shall* be determined under regulation or regulations prescribed by the Commissioners." (Emphasis supplied.)

Apparently, where the business is carried on *solely* in the District and the entire net income arises therein regu-

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[11] Formal submission of the three factor formula to the Commissioners and action thereon will appear from the Appendices A, B, and C to this opinion.

[12] That is to say, when the business is carried on within and without the District. See preceding portion of Section 47-1580a of the Code.

lations or formulae are not necessary. They are only needed where the income is to be deemed to be from sources *both within* and *without* the District.

There are two suggestions or insinuations that need comment. The first is that, if all of a corporation's products manufactured outside the District are not sold therein, a one factor formula of sales would meet the requirement of the law, since it could be said that a part of the net income from the (entire) business of the corporation is deemed to be from sources without the District. The fallacy of that idea is due to overlooking the fact that the "trade or business" covered by the act is that relating to the District, which is a combination of "manufacturing and selling" and which is carried on in the manner stated in the *Underwood Typewriter Co.*, and *Bass, Ratcliff & Gretton* cases, above cited, both within and without the District. To use an extreme case as the acid test, in *Smoot Sand & Gravel Co.* v. *District of Columbia*, 104 U.S. App. D. C. 292, 261 F. 2d 758, 85 W.L.R. 1078, all of the taxpayer's products were manufactured or processed without the District. Ninety-five per centum was sold in the District, and that percentage of its net income was held to be taxable by the District [13] under a one factor formula of sales. If all of the products had been sold, one hundred per centum of its income would have been held taxable by the District under that formula.

The other suggestion is that since *net* income results from the deduction from *gross* income of all expenses, including those relating to manufacturing, the requirement for the apportioning of net income within and without the

[13] The U. S. Court of Appeals evidently overlooked the mandate of the statute as to apportioning the income within and without the District, or it may have been influenced by the fact that Smoot Sand & Gravel Company had its principal office in the District where all of its fiscal affairs were handled. Two-thirds, however, of its expenses were incurred in Maryland and Virginia.

District, where the business is carried on both within and without the District, is met by reason of such deduction. That suggestion, in the first place, overlooks the fact that all expenses, including that relating to selling the products, are deducted. Moreover, what we are trying to do in these types of cases is to find the locale of the commercial activity and what portion of the net income is fairly attributable thereto. The usual computation of net income involving the inclusion of items in gross income and deducting items of expense therefrom is not here involved. For practical purposes what is important in cases of this kind is the determination of what portion of net income results from the use of property, from the activities of administration and the like and from the process of selling.

For the reasons stated the Court does not believe that a one factor formula of sales can, consistent with the Act, be used where, as here, the trade or business involved is the manufacture of tangible personal property without, and the sale thereof within the District.

IV

The Eastman Kodak Company and the Panitz Cases

A great deal of confusion has arisen concerning a case decided some years ago by the United States Court of Appeals under the old District of Columbia Revenue Act of 1939, namely *Eastman Kodak Co.* v. *District of Columbia*, 76 U.S. App. D.C. 339, 131 F. 2d 347. In that case this Court, then the Board of Tax Appeals, upheld an income tax against Eastman Kodak Company on the entire net income from sales of its products in the District of Columbia. The amount of net income allotted to the District was computed by assigning to the District that proportion of the taxpayer's income as sales in the District bore to sales everywhere. The United States Court

of Appeals affirmed that holding. Several things must be kept in mind in relation to the *Eastman Kodak Company* case and to these cases. They arose under two differing statutes namely, the District of Columbia Revenue Act of 1939, and the District of Columbia Income and Franchise Tax Act of 1947, respectively. The taxes imposed on corporations by the two acts are different in several important and essential respects. *Flint* v. *Stone Tracy Co.*, 220 U.S. 107, 55 L. Ed. 389, 31 S. Ct. 342. The former imposed, as far as corporations were concerned, a pure income tax, while the latter levies a privilege tax, measured, it is true, by net income. The *Eastman Kodak Company* case was decided, certainly in this Court, on the severance theory, that is to say, that no income was earned until the property involved was sold—that "the fruit must be shaken from the tree", to speak figuratively; and that the place wherein the sale took place was where the income was realized. This Court and the Court of Appeals relied upon several Federal cases which were decided before the enactment of Section 119(c) of the Internal Revenue Code of 1939 (February 10, 1939).[14] The Federal law, as it existed earlier, and upon which those cases were based, was essentially the same as the District of Columbia Revenue Act of 1939. Section 119(c) of the Internal Revenue Code of 1939, however, materially changed the Federal law; and provided that income "from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States, *or produced (in whole or in part) by the taxpayer without and sold within the United States, shall be treated as derived partly from sources within and partly from sources without the United States*", which is substantially what that part of Section 47-1580a quoted above provides, *as far as this case is concerned*, that is to say, involving the manufacture of personal property *without*, and its

[14] See the cases cited in Footnote 6, 76 U.S. App. D.C. page 340.

sale *within* the District. It is interesting to note that Eastman Kodak Company sought to have the United States Court of Appeals determine the question of tax liability on the basis of the then new Section 119(c) of the Internal Revenue Code of 1939, but that Court refused to do so and as stated above affirmed the above mentioned decision of this Court.

It should here be noted that the most important, and indeed, controlling difference between the District law involved in the *Eastman Kodak Company* case and the District of Columbia Income and Franchise Tax Act of 1947 is that the former law did not, as does the latter (Section 47-1580a of the Code) provide that where the taxpayer's business is carried on within and without the District the net income, for the purpose of measuring the tax, must be deemed to be from sources *within* and *without* the District. Another difference between the 1939 and 1947 District laws is that under the former, since the income was earned where the sale was made, the passing of title, which usually completes a sale of personal property, was determinative, while under the latter the passing of title is of no determinative effect, which was due to, or came about by the following. The decision in the *Eastman Kodak Company* case in favor of the District was a Pyrrhic Victory. The manufacturers quickly adopted a plan whereby title and possession of goods shipped from points outside to customers within the District passed to the customers at a point outside the District. The United States Court of Appeals in *Electric Storage Battery Co. v. District of Columbia*, 81 U.S. App. D.C. 135, 155 F. 2d 867, set aside a District of Columbia income tax where the title to goods in a f.o.b. shipment passed to the customer outside the District. That and other cases, and the effect of the *Eastman Kodak Company* case and its use by the manufacturers resulted in the promotion by the District of the enactment of the District of Columbia

Income and Franchise Tax Act of 1947,[15] which, as far as corporations and unincorporated businesses are concerned, has two principal advantages to the District, namely, nullification of the effect of the passing of title and the elasticity of a franchise tax which could be measured by income attributable to business carried on in the District, regardless of the locale of the sale or the real source of income in the concept of pure income taxation. Congress did, however, as above observed, provide, as protection for multistate businesses, that where the business was carried on both within and without the District the net income from such business had to be considered income from sources without, as well as within the District.

Panitz v. *District of Columbia*, 74 U.S. App. D.C. 284, 122 F. 2d 61, 69 W.L.R. 891, has been frequently cited in support of a one factor formula of sales. Like the *Eastman Kodak Company* case, the law involved in the *Panitz* case was materially different from the Income and Franchise Tax Act,—even more so. The *Panitz* case arose under the old Business Privilege Tax Act in the District of Columbia Revenue Act of 1937. It simply imposed an excise tax measured by gross receipts from business carried on in the District "without any deduction therefrom on account of the cost of the property sold, the cost of materials, labor or services or other costs * * * or any expense whatsoever". All that was there decided was that a tax on the gross receipts from the commercial activity of sales (as required by the law) in the District was proper. There was no provision in the taxing statute requiring any apportionment, as does the present law, nor any provision similar in the slightest degree to the requirement in the current Act that, if the business is carried on both within and without the District, the net income must be apportioned accordingly.

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[15] Chapter 15 of Title 47, D.C. Code, 1951 Edition.

The provision in Section 47-1580a of the Code providing that, if the trade or business is carried on within and without the District of Columbia, the net income must be deemed to be income from sources without, as well as within the District, has not only been ignored in the regulations, but has received no comment by counsel for the District in their brief in this case, although this Court has repeatedly referred to that provision as not only important, but controlling as well. The Court is at a loss to understand the failure on the part of counsel to discuss the provision in relation to these cases and to the facts stipulated by the parties.

V

Other Cases Cited To Support A One Factor Formula

Several Supreme Court cases have frequently been cited to support a one factor formula in the taxation of net income or gross receipts from unitary businesses or corporations. The cases do support the use of such a formula, *if the particular statute so provides.* In none of the cases did the taxing statute provide, as does the District law, for the apportionment within and without the taxing jurisdiction where the business is carried on within and without that area. The cases, briefly discussed, are the following:

Maine v. *Grand Trunk Rwy. Co.*, 142 U.S. 217, 35 L. Ed. 994, 12 S. Ct. 121. Really not an apportionment case. The method to be used was specifically spelled out in the Maine statute.

Underwood Typewriter Co. v. *Chamberlain, supra.* Unlike or exactly opposite from the District statute, the Connecticut law specifically provided that, if the business was carried on both within and without the State, the tax should be computed by the use of a one factor formula of property within Connecticut.

Bass, Ratcliff & Gretton, Ltd. v. *State Tax Commission, supra.* The taxing statute provided specifically for a one factor formula of real and personal property in New York.

National Leather Co. v. *Massachusetts,* 277 U.S. 413, 72 L. Ed. 935, 48 S. Ct. 534. Taxing statute specifically provided for use of a one factor formula of real and personal property employed in business in Massachusetts.

It should be added that in respect of the *Underwood Typewriter Co., Bass, Ratcliff & Gretton, Ltd.* and *National Leather Co.* cases the Supreme Court in the *Hans Rees' Sons* v. *North Carolina, supra,* indicated, as did our Court of Appeals in *Smoot Sand & Gravel Co.* v. *District of Columbia, supra,* that the decisions sustaining the one factor formulas turned largely upon the failure of evidence. This is what the Supreme Court said in the *Hans Rees' Sons* case.

> "* * * Evidence which was found lacking in the Underwood and Bass Cases is present here. *These decisions are not authority for the conclusion that, where a corporation manufactures in one state and sells in another, the net profits of the entire transaction, as a unitary enterprise, may be attributed, regardless of evidence, to either state.* In the Underwood Case, it was *not* decided that the entire net profits of the total business were to be allocated to Connecticut because that was the place of manufacture, or, in the Bass Case, that the entire net profits were to be allocated to New York because that was the place where sales were made. In both instances, a method of apportionment was involved which, as was said in the Underwood Case, 'for all that appears in this record, reached, and was meant to reach, only the profits earned within the state.' The difficulty with the evidence offered in the Underwood Case was that it failed to establish that the amount of net income with which the corporation was

charged in Connecticut under the method adopted was not reasonably attributable to the processes conducted within the borders of that state; and in the Bass Case the Court found a similar defect in proof with respect to the transactions in New York." (Emphasis supplied.)

New York v. *Latrobe*, 279 U.S. 421, 73 L. Ed. 776, 49 S. Ct. 377. Unlike the District law, the New York statute specifically provided that the license fee for a corporation be based upon that proportion of its corporate stock that gross assets employed within the state bore to its gross assets employed everywhere. *It was a corporate stock valuation case.*

Ford Motor Co. v. *Beauchamp*, 308 U.S. 331, 48 L. Ed. 304, 60 S. Ct. 273. Unlike the District statute, Texas Annotated Civil Statute, Article 7084 specifically imposed "a franchise tax * * * based upon that proportion of the outstanding capital stock, surplus and undivided profits, plus the amount of outstanding bonds, notes and debentures, other than those maturing less than a year from date of issue, as gross receipts from its business done in Texas bears to the total gross receipts of the corporation from its entire business, * * *."

International Harvester Co. v. *Evatt*, 329 U.S. 416, 91 L. Ed. 390, 67 S. Ct. 444. The Ohio statute specifically provided the formula to be used. Incidentally, the Ohio statute provided a *two* factor formula, namely, of property and "business done" in Ohio.

Actually, all that the foregoing Supreme Court cases decided was that the use of the formulas specifically provided in the various statutes did not violate the Constitution.

A state case, *Household Finance Co.* v. *State Tax Com.*, 212 Md. 80, 128 A. 2d 640, relied upon to support the use of a one factor formula should be briefly discussed. That

case really supports the principle that, if business is carried on within and without the District the net income must be deemed income within and without the District. The Maryland statute required the State Tax Commission, in the valuation of corporate stock relating to Maryland, to exclude business and property outside the state. The order of the State Tax Commission did not follow the law. On appeal to the Court of Appeals of Maryland the order of the Commission was modified to comply with the law. Moreover, a statutory formula or method was provided.

VI

The Gallant Case

District of Columbia v. *Gallant, Incorporated,* U.S. App. D.C. , 290 F. 2d 745, dealt with a regulation adopted by the Commissioners on August 6, 1953, for the enforcement and administration of the foregoing provisions of the Income and Franchise Tax Act.[16] The portion of the regulation with which we are here concerned is Section 10-2(c). The first sentence comports with the Act. It is the following:

> "If the trade or business is carried on or engaged in *wholly* within the District, the entire net income from trade or business shall be *allocated* to the District." (Emphasis supplied.)

The next portion of the regulation, Subsection (1)(a) of Section 10-2(c), attempts to prescribe, or has for its sole purpose the prescribing of a formula for the determination of the net income taxable by the District, that is to say, "*fairly* attributable" to any trade or business carried on in the District. The United States Court of Appeals in the *Gallant* case held that the subsection was *valid*, but that it failed in its purpose, or, to use the language in

[16] Chapter 15 of Title 47, D.C. Code, 1951 Edition.

the opinion, "failed to provide a 'formula' as the term is ordinarily understood in the regulation". Later in the opinion is found this language (290 F. 2d at page 748):

> "However, irrespective of the authority of the Assessor, the Tax Court itself cannot be precluded, for lack of a regulatory formula, from determining the income which is fairly apportionable to the District. Cf. *McCeney* v. *District of Columbia*, 97 U.S. App. D.C. 282, 230 F. 2d 832 (1956). The Tax Court is, under Section 47-2403, to hear and determine 'all questions arising' on the appeal—here the question of what income is fairly attributable to the District —and it may 'reduce or increase' the assessment as required under its determination of such questions.
>
> "The case is remanded to the Tax Court for further proceedings not inconsistent with this opinion. The Tax Court is directed to determine the amount of the income which is fairly attributable to the District by applying the August 6, 1953, regulations, including if necessary the use of such formula or formulae as the Tax Court deems best suited for determination of that question in this case. * * *."

In Footnote numbered 4, relating to the regulation of August 6, 1953, is the following: "If a valid and pertinent regulation is promulgated by the Commissioners, the Tax Court must obey it and properly apply it." It is not supposed that the Court of Appeals meant that any regulation adopted by the Commissioners relating to the subject matter here involved should be given retroactive effect in face of the well established principle that such cannot be done if, as decided in the *Gallant* case, there was a valid regulation in effect during the prior year. *District of Columbia* v. *Radio Corporation of America*, 98 U.S. App. D.C. 119, 232 F. 2d 376, 84 W.L.R. 918, cert. denied, 352 U.S. 845, 1 L. Ed. 2d 51, 77 S. Ct. 44. But assuming that the United States Court of Appeals might have intended an exception or relaxation of the rule and

intended that any new regulation be given retroactive effect, as was assumed in this Court's Memorandum on Remand in the *Gallant* case, this Court is of the opinion that, for the reasons stated in that memorandum, to which reference is here made to avoid repetition, the regulation adopted by the Commissioners on July 14, 1961, purporting to relate or pertain to the foregoing provisions of the Income and Franchise Tax Act (See Sections 47-1580 and 47-1580a of the Code) is invalid. The principal objection to the July 14, 1961, regulation is that to apply it in this case to the trade or business involved would violate the plain and unambiguous provision of Section 47-1580a of the Code that "If the trade or business of any corporation * * * is carried on or engaged in both within and without the District, the net income derived therefrom shall, for the purposes of this article, be deemed to be income from sources within and without[17] the District." The Court is of the opinion, therefore, that the use of the July 14, 1961, regulation in this case would be improper.

VII

The Best Suited Formula

In the light of the *Gallant* case, the Court believes that it is its duty to determine the amount of net income that was fairly attributable to the District of Columbia within the meaning of Section 47-1580 and 47-1580a of the Code, and to use such formula or formulae as will be agreeable to, and not violative of any provisions of those sections. This Court assumes, of course, that the United States Court of Appeals requires that in adopting a formula this

[17] It is important to note that the use of the phrase *"within and without the District"* shows that the term "trade or business" includes that which is done without as well as within the District, otherwise the provision would be meaningless or at least, unnecessary, since there would never be any occasion for its use.

Court follow all pertinent provisions of the taxing statute. With that in mind and considering the nature and extent of the trade or business carried on by the petitioner in relation to the District, that is to say, the manufacture of a certain quantity of products and administrative activities without the District and the sale of those products within the District, the Court is of the opinion that a formula is necessary for the determination of the portion of petitioner's net income which was fairly attributable to business carried on within the District within the meaning of Section 47-1580 and 47-1580a of the Code; and that the formula best suited for that determination is the following:

> The portion of petitioner's net income fairly attributable to the trade or business carried on or engaged in within the District of Columbia by the petitioner during the taxable years 1957 and 1958 shall be determined by multiplying its total net income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.
>
> 1(a) The property factor is a fraction, the numerator of which is the average value of the petitioner's real and tangible personal property owned or rented and used by the petitioner in the District during the taxable year, except property from which petitioner derived net income subject to direct allocation under the regulations pertaining to the District of Columbia Income and Franchise Tax Act of 1947,[18] and the denominator of which is the average value of all the

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[18] For example, real estate rented to tenants, the rents therefrom being "such other income as is derived from sources within the District", within the meaning of Sections 47-1580 and 47-1580a of the Code, the net income from which is taxable separately from that derived from "trade or business". *D. C.* v. *Evening Star Newspaper Co.*, 106 U.S. App. D.C. 360, 273 F. 2d 95, 87 W.L.R. 1371.

petitioner's real and tangible personal property owned or rented and used during the taxable year.

(b) Property owned by the petitioner is valued at its original cost. Property rented by the petitioner is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the petitioner, less any annual rental rate received by it from sub-rentals.

(c) The average value of property shall be determined by averaging the value at the beginning and ending of the taxable year.

2(a) The payroll factor is a fraction, the numerator of which is the total amount paid in the District during the taxable year by the petitioner for compensation, and the denominator of which is the total compensation paid everywhere during the taxable year.

(b) Compensation is paid in the District, if:

(i) The individual's service is performed entirely within the District.

(ii) The individual's service is performed both within and without the District, but the service performed without the District is incidental to the individual's service within the District, or

(iii) Some of the service is performed in the District and (1) the base of operations, or, if there is no base of operations, the place from which the service is directed or controlled is in the District, or (2) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in the District.

3(a) The sales factor is a fraction, the numerator of which is the total sales by the petitioner in the District during the taxable year, and the denomina-

tor of which is the total sales by the petitioner everywhere during the taxable year.

(b) Sales of tangible personal property are in the District if:

(i) The property is delivered or shipped to a purchaser, including the United States, within the District of Columbia, regardless of the f.o.b. point or other conditions of the sale.

The foregoing formula is, incidentally, substantially similar to the formula provided for multi-state businesses in the Uniform Division of Income for Tax Purposes Act,[19] and to that recommended by the Finance Officer to the Commissioners in a memorandum dated March 22, 1961, and tentatively approved by the Commissioners on March 30, 1961 (See Appendices "A", "B" and "C" to this opinion). The formula, however, is adopted, because, in the opinion of the Court, it is intrinsically the best suited under the facts and in view of the nature of the trade or business involved herein.

The parties have stipulated facts sufficient for the application of the foregoing formula.

The Court has not overlooked the decision in the *Gallant* case that the regulation providing a one factor formula of sales is valid in that case. That decision, however, must be considered in the light of the circumstances in that case, that is to say, that the taxpayer, Gallant Incorporated, was engaged primarily in "the purchase and sale", and *not* "the manufacture and sale", with its principal office in the District, and sold the tangible personal property involved in that case *within* and *without* the District, which permitted the use of the sales factor only, without violating the *letter* of the directive in the Act that the

[19] Approved, 1957, by the National Conference of Commissioners on Uniform State Laws and by the American Bar Association.

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income had to be treated as earned, or from sources within and without the District, which would not be true in this case where the products involved were manufactured without but *sold* within the District. The use of the one factor formula in the *Gallant* case did deprive the District of Columbia of some revenue, but not all, so that, strictly speaking as observed above, the formula did not violate the letter of the law. The same is true of the *Southern Railway Co.*, *Evening Star Newspaper Co.* and *Thompson's Dairy, Inc.*, cases.

VIII

Computation of Taxes and Interest Due

Year 1957

The factors of property, payroll and sales as defined in the formula may be stated as follows:

	Everywhere	District of Columbia	District Percentage
Property [20]	$6,247,160,370	$ 1,360,676	.0218%
Payroll	$2,662,072,037	$ 1,268,180	.0477%
Sales	$9,461,855,874	$37,185,704	.3930%
Combined Percentages			.4625%
Total Percentages divided by 3 (average)			.1542%

The portion of petitioner's net income for 1957 fairly attributable to the business of manufacturing and selling its products carried on within the District is computed as follows:

[20] The item of "Property" includes both owned and rented property, the latter valued at 8 times the annual rent paid by petitioner.

Total Net Income	$1,312,092,839.00
Three Factor Apportionment Percentage	.1542%
Net Income Apportioned to District	$ 2,023,247.00
Plus Other Net Income from Sources in the District	10,320.00
Total Net Income Taxable by District	2,033,567.00
Rate of Tax	5%
Tax Due by Petitioner	101,162.25
Interest from 4/15/58 to 5/20/60 at ½ of 1% per month [21]	13,151.25
Total Tax and Interest Due for 1957	$ 114,313.50

YEAR 1958

The factors of property, payroll and sales as defined in the formula may be stated as follows:

	Everywhere	District of Columbia	District Percentage
Property	$6,403,673,576	$ 1,326,209	.0207%
Payroll	$2,354,049,741	$ 1,233,787	.0524%
Sales	$7,853,393,381	$32,542,519	.4144%
Total Percentages			.4875%
Total Percentages divided by 3 (average)			.1625%

The portion of the petitioner's net income for 1958 fairly attributable to business carried on within the District of Columbia by the petitioner is computed as follows:

[21] Section 47-1589c(b), D.C. Code, 1951 Edition, Supplement VIII, providing for interest on interest does not apply, because the amount assessed and demanded was exorbitant.

Total Net Income	$653,396,893.00	
Three Factor Apportionment Percentage		.1625%
Net Income Apportioned to District	$	1,061,769.00
Plus Other Net Income from Sources in the District		15,418.00
Total Net Income Taxable by District		1,077,187.00
Rate of Tax		5%
Tax Due by Petitioner		53,859.35
Interest from 4/15/59 to 5/20/60 at ½ of 1% per month [22]	$	3,770.15
Total Tax and Interest Due for 1958	$	57,629.50

[22] Section 47-1589c(b), D.C. Code, 1951 Edition, Supplement VIII, providing for interest on interest does not apply because the amount demanded in the assessment was exorbitant.

IX

COMPUTATION OF REFUND

YEAR 1957

The amount of franchise tax and interest for the year 1957 to be refunded to the petitioner is computed as follows:

	Tax	Interest	Total
Originally and Voluntarily paid by Petitioner	$ 4,198.70	None	$ 4,198.70
Deficiency paid by Petitioner	268,585.40	$35,379.40	303,964.80
Total paid by Petitioner	$272,784.10	$35,379.40	$308,163.50
Amount due by Petitioner	101,162.25	13,151.25	114,313.50
Refund payable to Petitioner	$171,621.85	$22,228.15	$193,850.00

YEAR 1958

The amount of franchise tax and interest for the year 1958 to be refunded to the petitioner is computed as follows:

	Tax	Interest	Total
Originally and Voluntarily paid by Petitioner	$ 1,500.00	None	$ 1,500.00
Deficiency paid by Petitioner	167,468.44	$11,860.89	179,329.33
Total paid by Petitioner	$168,968.44	$11,860.89	$180,829.33
Amount due by Petitioner	53,859.35	3,770.15	57,629.50
Refund payable to Petitioner	$115,109.09	$ 8,090.74	$123,199.83

X

CONCLUSION

For the reasons hereinbefore stated the Court holds as follows:

Docket No. 1698. That a deficiency in franchise tax for the calendar year 1957 in the amount of $171,621.85, and interest thereon in the amount of $22,228.15, or a total of $193,850.00, were erroneously assessed against and collected by the respondent from the petitioner; and that the petitioner is entitled to a refund thereof with interest thereon at the rate of 4 per centum per annum from May 20, 1960, to the date of the payment of the refund.

Docket No. 1699. That a deficiency in franchise tax for the calendar year 1958 in the amount of $115,109.09, and interest in the amount of $8,090.74, or a total of $123,199.83, were erroneously assessed against, and collected by the respondent from the petitioner; and that the petitioner is entitled to a refund thereof with interest thereon at the rate of 4 per centum per annum from May 20, 1960, to the date of the payment of the refund.

Decisions will be entered for petitioner.

[signed] Jo. V. Morgan
Jo. V. MORGAN,
Judge

[APPENDIX "A" TO OPINION]

GOVERNMENT OF THE DISTRICT OF COLUMBIA
DEPARTMENT OF GENERAL ADMINISTRATION
FINANCE OFFICE

March 22, 1961

MEMORANDUM TO THE COMMISSIONERS, D. C.
(Through the Director of General Administration)

SUBJECT:

Proposed amendment to the Income and Franchise Tax Regulations implementing the District of Columbia Income and Franchise Tax Act of 1947, as amended.

It is recommended that the Commissioners approve the attached proposed amendment to Subsection 10.2-(c)(1) of the Regulations pertaining to the District of Columbia Income and Franchise Tax Act of 1947, as amended. Subsection (1) of Section 10.2-(c) relates specifically to the methods to be employed in determining the portion of net income to be apportioned to the District in the case of a corporation or unincorporated business deriving income from sales of tangible personal property both within and without the District.

The District of Columbia Income and Franchise Tax Act of 1947, as amended, imposes a tax upon the taxable income of every corporation and unincorporated business, whether domestic or foreign (unless expressly exempt under the Act), for the privilege of carrying on or engaging in any trade or business in the District and of receiving income from sources within the District. "Taxable income" is defined in the Act to mean "the amount of net income derived from sources within the District within the meaning of Title X" of the Act.

Section 2 of Title X of the Act provides, in pertinent part, as follows:

> "Where the net income of corporation or unincorporated business is derived from sources both within and without the District, the portion thereof subject to tax under this article shall be determined under regulation or regulations prescribed by the Commissioners."

The present sales regulation was promulgated by the Commissioners in 1953 and provides for apportioning the net income of corporations engaged in selling tangible personal property both within and without the District in the ratio that District sales bear to sales everywhere. The present regulation defines the phrase "District sales" to mean:

> "* * * all sales to District customers the income from which is fairly attributable to the trade or business carried on or engaged in within the District, including solicitation in the District by salesmen or other representatives of the taxpayer, that portion of sales to customers outside the District the income from which is fairly attributable to the trade or business carried on in the District, and sales of tangible personal property the income from which is from District sources."

The foregoing regulation has been found to be both inequitable and unworkable not only at the administrative level but by the District of Columbia Tax Court. In *Smoot Sand and Gravel Corp.* v. *District of Columbia*, D.C.T.C. Docket No. 1340, decided September 4, 1957, the District of Columbia Tax Court, speaking of the present sales regulation, stated:

> "It will be noticed that the formula attempts to deal with three situations. The first involves sales to customers within the District of Columbia, the income

from which is 'fairly attributable etc.,' the second, to customers *outside* the District, the income from which is 'fairly attributable etc.,' and the third, 'sales of tangible personal property the income from which is from District sources.' When it is considered that the stated purpose of the formula is to determine what is 'fairly attributable to trade or business', and what is 'derived from sources in the District' the formula is meaningless. It is like saying 'fairly attributable' income is 'fairly attributable' income, and income derived from District sources is income derived from District sources.'

> And Lo! The Phanton Caravan has reached
> The Nothing it set out from—.

"There is no standard, no test, no yardstick, as in the earlier regulations, by which it may be determined what business activity will produce income that can be said to be 'fairly attributable to any trade or business' in the District. The provision in the regulation that 'District sales' include 'solicitation in the District by salesman or other representatives of the taxpayer' does not cure the defect, since there are many other activities connected with, or related to sales."

In a series of cases following the foregoing decision, the District of Columbia Tax Court has consistently refused to apply the present regulation. Needless to say, it has become virtually impossible to deal with taxpayers such as General Motors Corporation, General Foods Corporation, the Lever Brothers Company, Radio Corporation of America, Ford Motor Company, and every other corporation, large and small alike, in the face of the position taken by the Tax Court and the resulting nebulous status of the present sales regulation.

On February 7, 1961 there was forwarded to the Commissioners, D. C., through the Director of General Ad-

ministration, a proposed amendment to Section 10.2-(c) of the Income and Franchise Tax Regulations. That amendment contained, *inter alia*, a new three-factor formula, composed of property, payroll and receipts, for apportioning to the District a fair and reasonable portion of the net income of service-type businesses which operate both within and without the District. What we said there concerning the use of a three-factor formula as opposed to a single-factor formula is equally applicable herein. Suffice to say that a three-factor formula consisting of property, payroll and sales is the most accurate and equitable method yet devised for apportioning among the States the taxable net income of corporations operating in a number of States. In cases involving questions of apportionment of income of multistate businesses, the Supreme Court of the United States has stated many times that arithmetical accuracy is not possible in this difficult area of taxation, and mathematical precision is not required.

The three-factor formula set forth in the proposed amendment has been enacted or recommended for enactment, in whole or in part, by some twenty States, and is gaining widespread recognition as the most effective and accurate method yet conceived for apportioning business income among the several taxing jurisdictions. It has been endorsed for use by all of the States, on a uniform basis, by most, if not all, of the major associations of State assessors and tax administrators, and by the House of Delegates of the American Bar Association.

While it is not possible to estimate with any degree of accuracy the revenue effects of the adoption of the proposed three-factor formula, its adoption will bring about some decrease in revenue. This decrease in revenue will be offset to some extent by the increase in revenue anticipated from the adoption and application of the three-factor formula relating to service-type business. Also, it

is believed that the adoption of the three-factor formula contained in the proposed amendment will produce certain tangible and intangible economic benefits. Corporations have been moving their offices from the District at an alarming rate over the past several years chiefly, we believe, in an effort to avoid liability for payment of District corporation franchise taxes. It is believed that most of the corporations which have removed their offices from the District have done so because of the inequitable results flowing from the application of the present single-factor sales formula, and would not have done so if the District had had in effect a three-factor formula for measuring the amount of their taxable income to be apportioned to the District. If by the adoption of the proposed amendment large corporations can be persuaded to remain in the District, or to move their offices into the District, it follows that the District will benefit therefrom not only tax-wise, but in many ways. The whole economy of the District would be revitalized, and a dangerous trend would have been stemmed. In addition, several states which anticipated a loss of revenue prior to the adoption by them of such a three-factor formula have reported that such loss was not in fact incurred.

Under the proposed amendment the property and payroll factors for sales corporations are, with one minor exception, the same as the property and payroll factors for service-type corporations. Generally, the sales factor attributes to the District all sales of tangible personal property delivered or shipped to a purchaser within the District. Sales of tangible personal property to the United States Government are separately considered in accordance with the provisions of the Act relating to such sales.

It is imperative for the proper enforcement of the Income and Franchise Tax Act that the present regulation pertaining to sales corporations be amended. Since the District of Columbia Tax Court refuses to apply the pres-

ent regulation, the Finance Office has been placed in an untenable position in its dealings with corporate taxpayers. It is believed that the proposed three-factor formula comes as near to complete equity as is possible in this complex area of taxation.

It is recommended that the attached proposed amendment to Section 10.2-(c) of the Income and Franchise Tax Regulations be referred to the Corporation Counsel for technical legal review with instructions to incorporate this proposed amendment to Section 10.2-(c) of the Regulations with the proposed amendment to Section 10.2(c), which was forwarded to the Commissioners on February 7, 1961. It is further recommended that, after review by the Corporation Counsel, a public hearing be held on the proposed amendments after which, with such changes as may appear necessary, the attached proposed amendment be approved by the Commissioners to become effective January 1, 1962.

Finance Officer

Approval recommended:

Director of General Administration

[APPENDIX "B" TO OPINION]

PROPOSED AMENDMENT TO SECTION 10.2-(c)(1) OF THE REGULATIONS PERTAINING TO THE DISTRICT OF COLUMBIA INCOME AND FRANCHISE TAX ACT OF 1947, AS AMENDED.

(8) Where income for any taxable year is derived from the manufacture and sale or purchase and sale of tangible personal property, the portion thereof to be apportioned to the District shall be determined by multiplying the total

net income from such trade or business by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

(a) The property factor is a fraction, the numerator of which is the average value of the real and tangible personal property owned by, rented to, or used by the taxpayer in the District during the taxable year, and the denominator of which is the average value of the real and tangible personal property owned by, rented to, or used by the taxpayer everywhere: Provided, that neither the numerator nor the denominator of the property factor shall include property, or any portion thereof, the taxpayer's income from which is subject to direct allocation of these regulations, or which is used by the taxpayer in a trade or business, the income from which is allocable or apportionable under another method or formula of these regulations. Where property is used in any activities the income from which is allocable or apportionable partly under this subsection and partly under another section or subsection of these regulations, the taxpayer may employ, subject to the approval of the Assessor, or the Assessor may require the use of any method which will reflect properly the portion of the average value thereof to be used in arriving at the property factor under this subsection.

Property owned by the taxpayer is valued at its original cost to the taxpayer. Property rented to or used by the taxpayer is valued at eight times the net annual rental rate which is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals, provided that such rental and subrental rates are reasonable. The term "net annual rental

rate" includes amounts paid or accrued for the use or rental of the property or facilities of another whether paid as rent, reasonable compensation for use or by any other designation, and whether paid pursuant to statutory enactment, lease or rental agreement of any kind, contract, or otherwise. If the Assessor shall determine that any net annual rental rate or subrental rate is unreasonable, or if no rate is charged, he may determine and apply such rate as will reasonably reflect the average value of the property rented to or used by the taxpayer.

The average value of property shall be determined by averaging the values at the beginning and end of the tax period, but monthly or quarterly values of property may be used by the taxpayer, subject to the approval of the Assessor, or the Assessor may require the use of such values if reasonably necessary to reflect properly the average value of property owned by, rented to, or used by the taxpayer during the tax period.

(b) The payroll factor is a fraction, the numerator of which is the total compensation paid or accrued by the taxpayer in the District during the taxable year, and the denominator of which is the total compensation paid or accrued by the taxpayer everywhere during the taxable year. "Compensation" means wages, salaries, commissions, and any other form of remuneration paid or accrued to officers and employees for personal services, and, in the case of unincorporated businesses, compensation also means wages, salaries, commissions, and any other form of remuneration paid or accrued to the individual owners and members for personal services actually rendered without regard to the 20 per centum limitation provided for in Section

3(a)(15) of Title III. Compensation paid or accrued other than in cash shall be valued at its fair market value as of the date of payment or accrual, whichever is earlier. Compensation is paid or accrued in the District if—

(1) the individual's service is performed within the District, or

(2) the individual's service is performed within and without the District, but the service is performed primarily within the District, or

(3) some of the individual's service is performed in the District and (A) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the District or (B) the base of operations or the place from which the service is directed or controlled is not in the District or in any state in which some part of the service is performed, but the individual's residence is in the District.

Where compensation is paid or accrued for services the income from which is allocable or apportionable partly under this subsection and partly under another section or subsection of these regulations, the taxpayer may employ, subject to the approval of the Assessor, or the Assessor may require the employment of any method which will reflect properly the portion thereof to be used in arriving at the payroll factor under this subsection.

(c) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in the District during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year.

Sales of tangible personal property to the United States Government are in the District if the income

derived therefrom is not excluded from gross income as provided in Title III, Section 2(b)(13) of the Act. Sales of tangible personal property, including sales to the United States Government, are in the District, regardless of the point of passage of title, f.o.b. point, or other conditions of such sales, if—

(1) the property is delivered or shipped to a purchaser within the District, or

(2) the property is delivered or shipped to a point outside the District but the ultimate destination of such property is a purchaser within the District, or

(3) the property is delivered or shipped to a purchaser outside the District but such sales result from orders taken or solicited by employees, agents or representatives of the taxpayer located in the District, or placed with or through an office or other place of business of the taxpayer in the District and such sales are not taxed to the taxpayer by the state to which the property is shipped.

March 22, 1961

[APPENDIX "C" TO OPINION]

GOVERNMENT OF THE DISTRICT OF COLUMBIA EXECUTIVE OFFICES WASHINGTON, D. C.

March 30, 1961

MEMORANDUM TO THE CORPORATION COUNSEL:

Forwarding, herewith, memorandum, under date of March 22, 1961, addressed to the Commissioners, by the

Finance Officer, entitled: "Proposed amendment to the Income and Franchise Tax Regulations implementing the District of Columbia Income and Franchise Tax Act of 1947, as amended".

Your attention is invited to the last paragraph of this memorandum, which reads as follows:

> "It is recommended that the attached proposed amendment to Section 10.2(c) of the Income and Franchise Tax Regulations be referred to the Corporation Counsel for technical legal review with instructions to incorporate this proposed amendment to Section 10.2(c) of the Regulations with the proposed amendment to Section 10.2(c) which was forwarded to the Commissioners on February 7, 1961. It is further recommended that, after review by the Corporation Counsel, a public hearing be held on the proposed amendments after which, with such changes as may appear necessary, the attached proposed amendment be approved by the Commissioners to become effective January 1, 1962".

The Commissioners, at their Board Meeting on March 28, 1961 approved this recommendation.

Secretary to the Board

/s/ GEOFFREY M. THORNETT

Attachements
/11
RF
GF
CC: Finance Officer
Mrs. Busch (Suspense)

APPENDIX B

UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

[Caption omitted]

Decided February 21, 1963

Before WILBUR K. MILLER, FAHY and DANAHER, *Circuit Judges.*

PER CURIAM: At the petition of General Motors Corporation, the District of Columbia Tax Court reviewed and reduced the assessments of the corporation franchise taxes for 1957 and 1958 which had been made against it by the District of Columbia. Refunds were ordered in accordance with the Tax Court's assessments. The District of Columbia appeals. Its principal point is that the court erred in using a formula consisting of the elements of property, payroll and sales, instead of employing only the element of sales, as the District had done. Other points are minor.

It is our view that the opinion of the Tax Court is an adequate treatment of the problems involved. We affirm its decisions.

So ordered.

FAHY, *Circuit Judge, dissenting:* The applicable District of Columbia franchise tax, §§ 47-1571, -1571(a), D.C. Code, 1961, "for the privilege of carrying on or engaging in any trade or business within the District and of receiving income from sources within the District," is 5 per centum upon the "taxable income" of a corporation

such as the respondent General Motors Corporation. And "taxable income" is defined generally to mean "the amount of net income derived from sources within the District." But if the trade or business is carried on both within and without the District, as in this case, the net income derived from the trade or business shall be deemed to be income from sources within and without the District. § 47-1580(a). The measure of the franchise tax shall be that portion of the net income of the corporation as is "fairly attributable to any trade or business carried on or engaged in within the District and such other net income as is derived from sources within the District. . . ." § 47-1580.

In such cases "the portion thereof subject to tax . . . shall be determined under regulation or regulations prescribed by the Commissioners." § 47-1580(a). This section also provides that the Assessor is authorized to employ any formula provided in any such regulation which, in his opinion, should be applied to determine the net income of any corporation subject to the tax. The formula thus employed and here under attack is set out in the margin.[1]

Regulations promulgated under the authority of enactments of the Congress have the force and effect of law, amounting in such a case as this to "filling up the details" of a statute. *Wayman* v. *Southard*, 23 U.S. (10 Wheat.)

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[1] "Where income for any taxable year is derived by the taxpayer from the manufacture and sale or purchase and sale of tangible personal property, the portion thereof to be apportioned to the District shall be such percentage of the total of such income as the District sales made during such taxable year bear to the total sales made everywhere during such taxable year. . . ." Sec. 10.2(c) as amended by Commissioners' Order No. 61-1214 of July 14, 1961.

This section then goes on to define District sales. We accept the Tax Court's delimitation of the case to the apportionment question, leaving aside any question as to the appropriateness of the definition of District sales.

1, 43 (1825). A court should be very slow to set aside such regulations.[2] Under the statute above referred to the District has established a formula by which net income attributable to District sources can be determined. Apportionment for purposes of ascertaining District income under this formula is based upon sales made in the District. No attempt is made to levy the franchise tax on any sales made elsewhere by General Motors. Thus the case is free of one of the difficulties involved in *District of Columbia* v. *Evening Star Newspaper Co.*, 106 U.S. App. D.C. 360, 273 F.2d 95 (1959).

The Tax Court of the District of Columbia is evidently of the view that what the statute means—though the statute does not so state—is that income from District sources must be deemed to be from internal and external sources (as opposed merely to deeming the taxpayer's total income to be both from within and without the District) when the trade or business is carried on externally as well as internally. It implies that this reading is especially called for when, as in this case, the taxpayer's principal offices and plants are located in other places. We are not unaware that the growing demand of states and cities for revenue has created a difficult problem where an interstate business is concerned. But in the present state of the law the District is authorized by Congress to assess a franchise tax on the basis of an apportionment which reaches income attributable to the District. The regulations of the Commissioners are designed to permit no less, and no more.[3]

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[2] See the dissenting opinion of Mr. Justice Black in *Brannan* v. *Stark*, 342 U.S. 451 (1952), where it is said: "[W]hen administrators have interpreted broad statutory terms . . ., we would recognize that it is our duty to accept this interpretation even though it was not 'the only reasonable one' or the one 'we would have reached had the question arisen in the first instance in judicial proceedings.'" 342 U.S. at 484.

[3] The case of *Hans Rees' Sons* v. *North Carolina*, 283 U.S. 123 (1930), is clearly distinguishable. While a single factor

It is urged that as a matter of economics income is produceable not alone out of sales but also by combining the elements of capital and labor. I do not disagree. And it may be assumed from an overall view of efficient taxation among the various taxing jurisdictions that a formula which takes into account these additional factors may be a more appealing one. But we have before us regulations drafted and applied by the officials authorized to do so, and I cannot say they are unreasonable under the authorizing statute. The assessments accordingly should not have been reduced by the Tax Court; that is to say, the Tax Court should not have superimposed a formula of its own.

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apportionment formula was there used it was so applied as "to reach profits which are in no just sense attributable to transactions within [the state]." The Court felt warranted in so concluding, because, though the taxpayer's plant was located in the taxing state, its sales were principally in other states and the state was determined to take a percentage of net income based on the relative size of assets within the state to holdings elsewhere. The Court did not condemn single factor formulae per se. *Cf. Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920), upholding a statute using a single factor formula.

APPENDIX C

UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

[Caption omitted]

On Rehearing en banc

Decided February 13, 1964

Before: BAZELON, Chief Judge, WILBUR K. MILLER, FAHY, WASHINGTON, DANAHER, BASTIAN, BURGER, WRIGHT and MCGOWAN, Circuit Judges sitting *en banc*.

MCGOWAN, *Circuit Judge*, with whom *Chief Judge* BAZELON and Circuit Judges FAHY, WASHINGTON and WRIGHT join: These petitions for review from the District of Columbia Tax Court involve the propriety of assessments under the District's Income and Franchise Tax Act against General Motors Corporation for the years 1957 and 1958. The tax is levied on the net income of General Motors for the privilege of carrying on business within the District; and, as such, is similar to taxes levied by many of the States. The question before this court concerns the legally permissible formula for determining that portion of the net income of a unitary multi-state business which is properly taxable by the District of Columbia. The Tax Court ruled that the District's single-factor formula of apportionment was not permitted by the statute; and, on its own initiative, substituted a three-factor formula. A division of this court, one judge dissenting, affirmed the Tax Court. Because of the importance of the problem to the administration of local taxes, we granted

the District's petition for rehearing *en banc*. We now decide that the decisions of the Tax Court must be reversed.

I

The District of Columbia Code imposes a "franchise tax upon every corporation . . . for the privilege of carrying on or engaging in any trade or business within the District and of receiving such other income as is derived from sources within the District," to be measured by "that portion of the net income of the corporation . . . as is fairly attributable" to that business.[1] Where the business "is carried on or engaged in both within and without the District, the net income derived therefrom shall . . . be deemed to be income from sources within and without the District," and the portion subject to tax shall

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[1] D.C. Code § 47-1580:

"It is the purpose of this subchapter to impose (1) an income tax upon the entire net income of every resident and every resident estate and trust, and (2) a franchise tax upon every corporation and unincorporated business for the privilege of carrying on or engaging in any trade or business within the District and of receiving such other income as is derived from sources within the District: *Provided, however*, That, in the case of any corporation, the amount received as dividends from a corporation which is subject to taxation under this subchapter, and, in the case of a corporation not engaged in carrying on any trade or business within the District, interest received by it from a corporation which is subject to taxation under this subchapter shall not be considered as income from sources within the District for the purposes of this subchapter. The measure of the franchise tax shall be that portion of the net income of the corporation and unincorporated business as is fairly attributable to any trade or business carried on or engaged in within the District and such other net income as is derived from sources within the District; *Provided further*, That income derived from the sale of tangible personal property by a corporation or unincorporated business not carrying on or engaging in trade or business within the District as defined in sections 47-1551 to 47-1551c shall not be considered as income from sources within the District for purposes of this subchapter, with the exception of income from sale to the United States not excluded from gross income as provided in section 47-1557a (b) (13)."

be determined by regulations prescribed by the District Commissioners.[2]

Under regulations promulgated August 6, 1953, the formula for determining the tax of a sales corporation engaged in business "partly within and partly without the District" is based on a sales factor. The portion taxed by the District is the percentage of the corporation's total net income (determined under other sections of the District Code not here in direct controversy) that its "District sales made during such taxable year bear to the total sales made everywhere during such taxable year."[3]

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[2] D.C. Code § 47-1580a:

"The entire net income of any corporation or unincorporated business, derived from any trade or business carried on or engaged in wholly within the District shall, for the purposes of this subchapter, be deemed to be from sources within the District, and shall, along with other income from sources within the District, be allocated to the District. If the trade or business of any corporation or unincorporated business is carried on or engaged in both within and without the District, the net income derived therefrom shall, for the purposes of this subchapter, be deemed to be income from sources within and without the District. Where the net income of a corporation or unincorporated business is derived from sources both within and without the District, the portion thereof subject to tax under this subchapter shall be determined under regulation or regulations prescribed by the Commissioners. The Assessor is authorized to employ any formula or formulas provided in any regulation or regulations prescribed by the Commissioners under this subchapter which, in his opinion, should be applied in order to properly determine the net income of any corporation or unincorporated business subject to tax under this subchapter."

The rate of tax is 5% (D.C. Code § 47-1571a) of the corporation's "taxable income," which is defined in D.C.Code § 1571 as "the amount of net income derived from sources within the District within the meaning of sections 47-1580 to 47-1580b."

[3] "Section 10.2-(b): 'Allocated' and 'Apportioned' Defined. The word 'allocated' as hereinafter used in reference to income and deductions therefrom means a determination based upon actual figures specifically applicable thereto; and the word 'apportioned' as hereinafter used in reference to net income means a ratable portion determined on a percentage basis. If the entire net income is de-

rived from engaging in a trade or business within the District or from sources within the District, all of such income shall be allocated to the District. If the net income is derived from engaging in a trade or business partly within and partly without the District, or from sources both within and without the District, such income shall be allocated and apportioned in accordance with the specific provisions or formulae prescribed in these Regulations."

"Section 10.2-(c): Income Attributed to the District of Columbia. If the trade or business is carried on or engaged in wholly within the District, the entire net income from trade or business shall be allocated to the District. If the trade or business is carried on partly within and partly without the District, that portion of the net income from trade or business to be apportioned to the District shall be determined as follows:

(1) Income from sales of tangible personal property.

(a) Where income for any taxable year is derived from the manufacture and sale or purchase and sale of tangible personal property, the portion thereof to be apportioned to the District shall be such percentage of the total of such income as the District sales made during such taxable year bear to the total sales made everywhere during such taxable year. Every corporation and unincorporated business which carries on or engages in business in the District within the meaning of the words 'trade or business' as defined in the Act is, unless specifically exempted by some provisions of the Act, subject to tax. For the purpose of this regulation, the phrase 'District sales' shall mean all sales to District customers the income from which is fairly attributable to the trade or business carried on or engaged in within the District, including solicitation in the District by salesmen or other representatives of the taxpayer, that portion of sales to customers outside the District the income from which is fairly attributable to the trade or business carried on in the District, and sales of tangible personal property the income from which is from District sources."

These sections are as numbered in the Regulations of July 24, 1956, which reenacted without change the provisions relevant to this case.

On July 14, 1961, the District promulgated new regulations, in response to this court's decision in *District of Columbia* v. *Gallant Inc.*, 110 U.S.App.D.C. 202, 290 F.2d 745 (1961). The controversy in *Gallant* concerned the definition of "District sales," which was found deficient in the earlier regulations, rather than the propriety of the apportionment formula. As will be seen, only the latter point is at issue here. The apportionment formula remained the same as in the 1953 regulations. In *Gallant*, after a remand to the Tax Court and after the new regulations were promlulgated, the case again came before this court. 113 U.S.App.D.C. 92, 305 F.2d 761 (1962). We held that the 1961 regulations could not be applied

For the taxable years 1957 and 1958, General Motors paid a small tax on the theory that only that portion of its income which was derived from business conducted through a District office of one of its divisions constituted "District sales" which were "fairly attributable" to business done within the District. General Motors contended that other sales to dealers in the District did not constitute "trade or business" within the District. The District refused to accept the returns for either year, and in 1959 mailed notices of tax deficiencies. The District's theory was that income derived from sales of automobiles, other vehicles, and parts to dealers in the District was income from a "trade or business" carried on "partly within and partly without the District," and hence subject to apportionment for the purpose of determining the tax owed to the District. General Motors duly protested the notices of proposed deficiencies. After a hearing, the District Finance Officer rejected the protests and on February 4, 1960, a formal assessment of taxes due was mailed to the company.

General Motors paid the assessment under protest, and appealed to the Tax Court. In that court, two primary arguments were urged as to the invalidity of the assessed deficiencies: one, that the numerator of the sales formula was too broad, in that it included sales which were not "District sales"; and, two, that use of the single-factor apportionment formula itself was permitted neither by the District Code nor by the Constitution. General Motors requested that all of the additionally assessed tax be refunded.

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retroactively to determine the tax liability for 1956, but we expressed "no opinion as to whether the 1961 amendments are valid or whether they may in other cases or circumstances be applied retroactively." Since in this case the issue involved is the same under both the new and old regulations, we have no occasion to reconsider our holding in *Gallant*.

The Tax Court reversed the assessment, but not to the extent prayed for by General Motors. That court held the single-factor sales formula unauthorized by the District Code, and, in its place, substituted a three-factor formula of property, payroll and sales, each factor receiving equal weight.[4] The result was a tax substantially less than the District's assessment, but also substantially in excess of the amount originally paid by the taxpayer.

Only the District has appealed from the decisions of the Tax Court. General Motors has not, by an appeal of its own, pressed its original request to have the entire additional assessment refunded. For purposes of this appeal, it appears to concede the correctness of the figures found by the Tax Court as representing "District sales." The controversy before us, therefore, does not relate to the definition of what sales by General Motors properly may be taken to be "District sales," made in the course of a

[4] Numerous qualified economists testified for General Motors in the Tax Court. The general consensus of their testimony, relating to a unitary business such as the manufacturer and sale of personal property, was that the income realized from the sale of the finished product is earned by the business as whole, *i.e.*, by the combination of labor and capital beginning with the first stage in the manufacturing process, and ending with final sale. They contend the single-factor sales formula utilized by the District actually allocates to the jurisdiction where the final sale occurs all of the income which is earned at all stages. The Tax Court agreed. Because all of the products sold in the District were manufactured in other states, it "found" that the income from a sale made in District was actually earned "partly within and partly without" the District, and that the sales formula did not apportion that income as required by the District Code. The court held that the proper formula was one utilizing a combined ratio of General Motors' property in the District to total property, District payroll to total payroll, and District sales to total sales. The sales figures involved and not now in controversy are as follows:

	1957	*1958*
Total sales	$9,461,855,874.00	$7,853,393,381.00
District sales	37,185,704.00	32,542,519.00
Net Income (to be apportioned)	1,312,092,839.15	653,396,893.13

business activity which is carried on both within and without the District. It relates, rather, to the formula to be used for apportioning to the District that part of General Motors entire net income attributable to its "District sales." The District, of course, contends that the single-factor formula is valid. In addition, the District presents an alternative argument which was not made in the Tax Court, namely, that sales to dealers is "other income . . . derived from sources within the District." General Motors argues, first, that the District Code does not permit a formula based only on the sales factor; and, second, that such a formula, if authorized by the statute and as applied to it, is barred by the due process and commerce clauses of the Constitution. The Tax Court did not reach the constitutional issues.

II

Although not critical to a determination of this appeal in its present posture, some analysis of General Motors' operations in the District enlarges understanding of the issue we do face. The company's principal business is the manufacture and sale of automobiles, trucks and other vehicles, and parts and accessories. No manufacturing or assembly is conducted within the District, but takes place primarily in Michigan, Delaware, and Maryland as to products sold in the District. Orders from dealers are received and filled, and title passes, outside the District.

In addition to a central management staff located primarily in Detroit, Michigan, General Motors is organized into divisions, which operate substantially independently of each other. Of the five Car Divisions, four (Pontiac, Buick, Oldsmobile, and Chevrolet) have substantially identical operations throughout the country. Within the District in 1957 and 1958, Pontiac and Buick had four dealers each, Oldsmobile and Chevrolet five each. Subject to certain exceptions immaterial here, these divisions sold their products only to authorized dealers.

Each dealer operated under a "Dealer Selling Agreement" which contained a detailed recitation of the parties' obligations. Besides dealing with price (to the dealer, who was not obligated to resell the product at a particular price) and delivery terms, the agreement required the dealer to maintain a satisfactory place of business. Once the dealer was established in facilities and at a location mutually satisfactory to himself and the division, he agreed not to move to or establish a new or different location, branch sales office, branch service station, or place of business, including any used car lot or location, without the prior written approval of the division. Each dealer agreed to maintain specified standards for capital and net worth. He was required to use a uniform accounting system and submit 90-day sales projections, monthly financial and operating statements, and 10-day reports of sales and inventories; and to permit the company to examine his accounts and records when requested. Each agreement required satisfactory sales performance and service to purchasers, and an adequate staff and inventory of parts and accessories. The dealer was also required to erect certain specified signs necessary to advertise the company's products on a mutually satisfactory basis. Finally, the company could terminate the agreement for failure of the dealer to comply with its terms, and a dealer could terminate with or without cause by giving thirty days' notice.

The company's Motors Holding Division, with an office in the District, provided temporary financial assistance for the establishment, reorganization, or expansion of dealerships. In 1957 and 1958, four of the eighteen dealers in the District were receiving this financial aid. Under the program, the dealer provided at least twenty-five per cent of the required capital, and Motors Holding provided the remainder, in return for voting control. The dealer was required to buy Motors Holdings' interest

under a formula geared to operating results. During the program, he was required to submit financial reports every ten days, and an accounting supervisor and branch manager made periodic inspection visits.

Additional inventory financing was available to established dealers through General Motors Acceptance Corporation, a wholly-owned subsidiary which had an office in the District. When a dealer utilized this financing, security title passed to GMAC at the factory. During 1957 and 1958, the four District Pontiac dealers were financed by GMAC.[5]

For administrative purposes, each of the divisions had subdivided the country into "regions." Each region was further subdivided into "zones." As stipulated by the parties, the activities of the Pontiac Division organization are typical. The regional office which served the District was located in New York City. A zone office located in Chevy Chase, Maryland, part of the Washington Metropolitan Area, served the District, most of Virginia and Maryland, and small parts of Pennsylvania and West Virginia.[6] There were 120 Pontiac dealers in the zone in the taxable years here involved. The zone manager and his assistant made periodic visits (approximately once a month) to each dealer in the zone, for the purpose of advising on market opportunities, furthering the sale of promotional literature, and maintaining dealer interest in company items to aid the sale of Pontiac automobiles.

These goals were also furthered by one of four district managers who spent all of his time visiting dealers in the Washington Metropolitan Area (28 dealerships). Once a month each dealer submitted to the district man-

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[5] There is no indication in the record of the financing arrangements of the other dealers.

[6] The Oldsmobile and Buick zone offices serving the District were in Silver Spring, Maryland, also a part of the Washington Metropolitan Area.

ager a 90-day projection of new car requirements. Actual orders for new cars were usually sent directly to the zone office, although the district manager personally took orders to that office on occasion. The orders were processed at the zone office and forwarded for final approval to an assembly plant, where they were filled for shipment, f.o.b. factory, by common carrier directly to the dealer. The zone office also maintained a warehouse outside the District where a small inventory of new cars was kept, and sold from 50-100 cars a month therefrom. When purchased in this manner, the dealer himself would pick up the car from the warehouse.

Other zone office personnel who spent all or a portion of their time visiting and working with the dealers included an assistant zone manager (fifty per cent of his time); a business management manager (seventy-five per cent); a parts and service manager (seventy-five per cent); a claims administrator and his assistant (ninety per cent and one hundred per cent, respectively); and three service representatives (one hundred per cent). In addition to zone office personnel, national and regional Pontiac representatives made periodic visits to the zone.

With one exception, none of these Car Divisions maintained offices in the District. Chevrolet had a regional office in the District which supervised five zones. No dealer orders passed through the District office, but instead were sent directly to the Baltimore zone office, which also served the District. Personnel from Baltimore operated in the District in essentially the same manner as Pontiac's zone personnel. The Baltimore zone was responsible for processing owners' complaints regarding service by District dealers. It also initially passed upon applications for new dealerships, scrutinizing the business history and credit of an applicant. The regional office in the District then received the application and forwarded it with a recommendation to the Detroit office for final

approval. A fleet manager worked out of Chevrolet's regional office in the District. His function was to be in touch with local and national fleet users and promote fleet orders. Approximately forty per cent of his time was spent in Washington.

The Cadillac Division had a less elaborate organization than the other Car Divisions, but it still maintained similar organizational control. Cadillac operated through independently-owned distributorships, which in turn appointed dealers. Each distributor, who was also a dealer, performed functions similar to the zone offices of the other divisions. In 1957 and 1958, there was one distributor in the District, who also had the only Cadillac dealership in the District. Two other dealers in the surrounding area were appointed by him. The distributor was the primary contact with Cadillac's central offices, analogous to the zone offices of the other divisions. Dealers' reports, similar to those submitted by dealers in the other divisions, were channeled through the distributor to the Detroit office. A district manager employed by Cadillac supervised and coordinated the efforts of the seven distributors (forty-nine dealers) in the District and nearby states. He maintained a residence in the District and usually prepared his reports here. His primary function was to help the distributors, and through them the dealers, perform more efficiently.

Besides the Car Divisions, General Motors had several other operating divisions. GMC Truck & Coach Division operated under an organizational system similar to that of the four Car Divisions. It promoted the sale of vehicles and parts and supervised the activities of its dealers, who operated under Dealer Selling Agreements. There was one GMC Truck dealer in the District. A division representative and a service representative personally approached bus company customers in the District to promote coach sales and advise on service problems.

The Government Sales Section, the Cleveland Diesel Engine Division, the Detroit Diesel Engine Division, and the Allison Division also had offices in the District for the purpose of selling their products to the United States Government and to maintain general liaison with the Government.[7] None of the car or truck divisions made Government sales.

The United Motors Service Division, responsible for wholesale distribution of certain parts and accessories for General Motors products, maintained a zone office in the District. Orders taken in the District were filled from plants outside the District. The division maintained written agreements with wholesalers, seventeen of which were in the District.[8]

The AC Spark Plug Division maintained offices in the District only for liaison with the federal government. Nongovernment sales were made by personnel headquartered outside the District. Sales in the District, made to wholesalers and national accounts, were made by a territory manager, whose duty was to promote sales through sales meetings with the seven warehouse distributors in the District, sales contests, and display and merchandising programs.

Several administrative offices were maintained in the District. GMAC and Motors Holding Division have been previously discussed. The Business Research Staff had

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[7] So far as the record indicates, income from operations of these divisions is not involved in this case. D.C.Code § 47-1557a (b)(13) excludes from the definition of "net income"

> "Income derived from the sale of tangible personal property to the United States by corporations . . . having their principal places of business located outside the District, which property is delivered from places outside the District for use outside the District . . . ."

[8] It was the income derived from the operations of this division which General Motors originally contended was the only income taxable by the District.

the function of forecasting general economic conditions and their effect on the sale of company products. The General Motors Overseas Operations Division dealt with the United States and foreign governments and international agencies in respect of products sold abroad. The Patent Section conducted patent research and did some detail work regarding litigation. Its central Detroit office handled licensing and other business matters related to patents. The Public Relations Staff handled any necessary lobbying, relations with the press and other communications media, and general services to visiting executives.

On the basis of past decisions of this court,[9] it is clear that General Motors is engaged in "trade or business" within the District, as that term is defined in the District Code.[10] The company does far more than promote the sale of its products in the District for the benefit of what it calls "independent contractors." The provisions of the Dealer Selling Agreements constitute a continuing business relationship with its "authorized dealers," in which General Motors exercises a large degree of control over daily business operations. Additional control was exercised through the financial aid given by Motors Holding Division and GMAC. "[General Motors had] supervisory control over at least a substantial part of the business of the local [dealer] or representative or at least a part-time claim on the services of the individuals or organizations acting for it."[11]

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[9] *Lever Bros. Co.* v. *District of Columbia*, 92 U.S.App.D.C. 147, 204 F.2d 39 (1953); *cf. Fiat Motor Co.* v. *Alabama Imported Cars, Inc.*, 110 U.S.App.D.C. 252, 292 F.2d 745, *cert. denied*, 368 U.S. 898 (1961).

[10] D.C.Code § 47-1551c (h).

[11] *Lever Bros. Co.* v. *District of Columbia*, 92 U.S.App.D.C. at 149, 204 F.2d at 41.

For the same reasons that General Motors' operations subject it to taxation in the District, the provisions of Public Law 86-272, § 101,[12] do not remove it from the taxable jurisdiction of the District. That law, enacted in 1959, protects a business from taxation by a State if the only business activities within the State involve solicitation of orders for the business itself, or for its prospective customers. The law's proscription applies only in the case of these minimal business contacts. We think the facts already outlined are sufficient to show that the activities of General Motors surpass any mere solicitation of business.[13]

General Motors recognizes that neither the District Code nor P.L. 86-272 removes it from all taxation by the District. In its brief, it states that "[I]t will be noted that these protective statutes, construed and applied as we urge, although they forbid the assessments made in this case, do not exempt [the company] from paying to the District a franchise tax based on net income." The controversy we face, therefore, is not one as to the District's jurisdiction to tax General Motors at all, nor as to the number of dollars arising from the so-called District sales. Our problem is as to the propriety of the formula used to identify, in General Motors total net income, that portion which may be reasonably thought to flow from the District activities and sales.

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[12] 73 Stat. 555, 15 U.S.C. §§ 381-84. The law was passed in response to the Supreme Court's decision in *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450 (1959). See Hirshberg & Nedry, *A Federal Concept of Doing Business*, 46 VA. L. REV. 1241 (1960); Roland, *Public Law 86-272: Regulation or Raid*, 46 VA. L. REV. 1172 (1960). For present purposes, we assume that the law applies to the District and to the taxable years involved.

[13] The act also protects a business which sells only through "independent contractors," which are defined as persons selling or soliciting sales "for more than one principal." General Motors' dealers are not in that category.

III

The first issue we confront is whether the District Code permits use of the single-factor sales formula. The question is not a new one in this court, although this is the first time the whole court has had occasion to consider it.[14]

The statute, set forth above,[15] clearly does not require use of any particular formula. Nor can we discover a Congressional purpose or intent that a particular formula be utilized. The statute expressly delegates to the Commissioners the power to adopt any formula that will effectuate the taxing scheme devised by Congress. Thus, however much we might applaud a specific formula as a matter of wise fiscal and economic policy, we are not at liberty to substitute it for that adopted by the Commissioners. The most that we could do is to reject the Commissioners' approach as unauthorized.

The statute, in §§ 47-1580 and 47-1580a, contemplates three mutually exclusive sources of corporate net income taxable by the District. The first source, "allocated" to

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[14] The formula was specifically upheld as valid under the statute in *Smoot Sand & Gravel Corp. v. District of Columbia*, 104 U.S. App.D.C. 292, 261 F.2d 758, *cert. denied*, 359 U.S. 968 (1958), over the taxpayer's objection that its net income should have been "apportioned by a formula which takes into account its property values and operating costs, as well as sales; [and] that the regulation is invalid because it directs the apportionment of net income by considering only sales . . . ." In *Smoot*, we were in agreement with the Tax Court. However, three years later, in the first *Gallant* case, *supra*, the Tax Court ruled the single-factor formula invalid as not authorized by the statute. We reversed the Tax Court on that point, citing *Smoot*. In the instant case, the Tax Court again held the single-factor formula invalid, noting that in *Smoot* "[T]he U. S. Court of Appeals evidently overlooked the mandate of the statute as to apportioning the income within and without the District. . . ." It is evident, however, from the reported decision in *Smoot* that the panel deciding that case, with full awareness of this and other provisions of the statute, held that the District Code does not preclude the use of a single-factor sales formula.

[15] See footnotes 1 and 2, *supra*.

the District, is the income from a trade or business which is "carried on or engaged in wholly within the District." In such a situation, the gross income and expenses arise in the District, and the District is entitled to tax the entire net income from the business. The second source, also "allocated" to the District, is "other income . . . derived from sources within the District." Again the gross income and expenses arise in the District, and the District may tax the entire net income.[16] The third source, and the one in controversy here, is income from a trade or business conducted both within and without the District. The income from this source must be "apportioned," and only that portion attributable to the trade or business conducted in the District is taxable. The Commissioners' formula for making the required apportionment is as follows: Net income arising from activities within the District (and thus taxable) is to total net income of the corporation as sales made within the District is to total sales made by the corporation.[17]

It is this formula for apportionment that General Motors challenges and the Tax Court held unauthorized un-

[16] The District argues here that, regardless of whether General Motors' income from District sales is taxable under the provision applicable to corporations conducting a trade or business in the district, it is taxable as "other income . . . derived from sources within the District." Since the Tax Court held that the income from District sales was taxable under the "trade or business" provision and General Motors did not apeal that finding, and since we find the income to be fully taxable under the "trade or business" provision, we need not at this time pass on the scope of the "other income" provision. However, it should be noted that this court has interpreted that provision to cover income arising from transactions outside the scope of a regular "trade or business" carried on within the District, such as rents, royalties, and income from the sale of real property. *District of Columbia* v. *Evening Star Newspaper Co.*, 106 U.S.App.D.C. 360, 273 F.2d 95 (1959); see *Lever Bros. Co.* v. *District of Columbia*, *supra*. The interpretation called for by the District would result in an overlap of the two provisions not called for by the taxing scheme.

[17] Regulations Pertaining to Income & Franchise Taxes, promulgated on August 6, 1953, § 10.2 (c)(1)(a), set forth in footnote 3 *supra*.

der the statute. It is contended that the sales formula adopted is in conflict with the taxing scheme and allots to the District a greater portion of the income of unitary interstate businesses than was intended. This contention is based upon a theoretically possible reading of certain key words of the statute. That reading is at least implicitly in conflict with prior interpretations by this court.[18]

The crucial language is: "If the trade or business of any corporation . . . is carried on or engaged in both within and without the District, *the net income derived therefrom shall* . . . be deemed to be income from sources within and without the District." [Emphasis added.] D.C. Code § 47-1580a. General Motors and the Tax Court would interpret the words italicized to refer to net income *arising from activities in the District.* In this case, those activities principally involve sales. They then argue that the net income so earned must be "deemed to be income from sources within and without the District." Thus, the apportionment called for must be an apportionment of only this income. A permissible formula, under this interpretation, would first require a determination of the net income on the sales made in the District. Apparently the sales-income ratio would be appropriate for this purpose. But this is only the first step. The net income so determined would then be "apportioned" under a formula which would assign a part of the net income to each step in the manufacture-distribution process. This would recognize the fact that each step "earns" part of that income. The District would only be permitted to tax that part of the net income "earned" by the steps in the process which occur in the District, in this case prin-

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[18] See cases cited in footnote 14, *supra*. See also *Eastman Kodak Co.* v. *District of Columbia*, 76 U.S.App.D.C. 339, 131 F.2d 347 (1942) (considering the same question under the gross receipts tax in effect before 1947).

cipally the final sales step.[19] The District would not be permitted to tax that income economically attributable to the processing stages before sale, since they occur outside the District. This would call for some cost accounting formula that would divine the exact amount of income generated by each element of the manufacturing and distributing process through which a particular product passes on its way from raw materials to ultimate sale. They argue that the three-factor formula, while not a precise cost accounting method of separating and applying the net income from a sale to the various stages, is a rough equivalent and is therefore authorized by the statute, but that the single-factor sales formula is not authorized since it does not even attempt such an application.[20]

The District, on the other hand, argues, and we think correctly, that the net income to be apportioned is the net income from the entire business of the corporation rather than that income arising solely from District sales. To read the statute as General Motors requests, the word "therefrom" must refer only to net income arising from that part of a trade or business carried on *within* the District. But it seems clear to us, from a simple reading of the words used, that "therefrom" refers to the income

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[19] They concede that the income "earned" on activities in the District other than sales would also be taxable under this scheme.

[20] Whether anything short of a precise cost accounting system, which would fairly apply the net income to the various processes, would satisfy General Motors' reading of the statute is a serious but moot question. It is not at all clear that the three-factor formula is even a close approximation of the kind of economic breakdown called for. While there is some relationship between the cost of payroll and property attributable to a certain stage and the income arising from that stage, it is not at all certain what that relationship is. Moreover, the sales process, being the end product of all the other stages and responsible for the actual receipt of the *money* income, could be said to be the most important stage, thus permitting a greater proportionate share of the income to be assiged to it vis-a-vis the other steps in the process.

earned internally *and* externally by a corporation that carries on a trade or business both within and without the District, that is to say, its total income. Only by putting in language which does not appear can "net income" be restricted to that arising only from District sales. Read as we read it, the statute clearly permits, although it does not require, the single-factor sales formula adopted by the Commissioners.

The General Motors interpretation is obviously a complex and sophisticated one. We believe it more probable that the District's approach reflects the intent of Congress. A court should not apply a taxing statute more narrowly than its clear language imports unless there is some showing of Congressional intent that it should do so. The revenue act of which the franchise tax is a part was passed in 1947 to raise desperately needed revenues for the District. It was subjected to extensive study by a joint committee of Congress;[21] it was debated at length in the House and to a lesser extent in the Senate;[22] and several reports were written concerning it.[23] Nowhere in this material is there any indication that the crucial language in this section was intended to be read as General Motors suggests. This seems particularly important since, as we pointed out in the *Smoot* case, the prior gross receipts tax has been interpreted by this court to permit a single-factor sales formula similar to that presently used

[21] See *Hearings Before the Joint Subcommittee on Fiscal Affairs of the Committee on the District of Columbia on Methods of Acquiring Additional Revenue Through Taxes and Other Means*, 80th Cong., 1st Sess. (1947).

[22] See, *e.g.*, 95 Cong. Rec. 6629 (1947) (House); 95 Cong. Rec. 7357 (1947) (Senate).

[23] House Comm. on the District of Columbia, *Tax Legislation for the District of Columbia, Re: H.R. 3737*, Committee Print, 80th Cong., 1st Sess. (1947); S. Rep. No. 280, 80th Cong., 1st Sess. (1947); H.R. Rep. No. 543, 80th Cong., 1st Sess. (1947); H.R. Rep. No. 699, 80th Cong., 1st Sess. (1947); H.R. Rep. No. 801, 80th Cong., 1st Sess. (1947).

by the District.[24] It would seem that any intended change in application would have been indicated clearly by Congress.

Thus, we must find that the apportionment required relates to the entire net income of the corporation. We hold that the single-factor sales formula is permitted by the statute and, unless it is unconstitutional, the Tax Court must be reversed.

As noted above, the Tax Court invalidated the single-factor formula in this instance solely by reference to the statute and not to the Constitution. It expressly disclaimed the latter as a ground of decision because of the uncertainties it entertained as to its own status, i.e., court or administrative agency. We see no need to pursue this problem at this time, but we do think it appropriate to note that the record in this case was made up of evidence taken by the Tax Court, and its findings of fact are to be treated with the respect customarily accorded to the trier by a reviewing body.

One of those findings might well be thought to be conclusive upon us, absent any demonstration by us of a lack of foundation for it in the record. This is the last of the findings, No. 6, which is as follows:

> "The method used by the assessing authority of the District attributed to the District 100 per centum

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[24] See *Panitz* v. *District of Columbia*, 74 U.S.App.D.C. 284, 122 F.2d 61 (1941); *Eastman Kodak Co.* v. *District of Columbia*, *supra*. Moreover, the regulations promulgated in 1947, immediately after the Act was passed, included the same sales formula now in use. Regulations Pertaining to Income and Franchise Taxes, promulgated August 28, 1947, § 10-2 (d) (1). The Commissioners participated actively in the drafting of the Act and it would seem that they would have been aware of any intended change. This is not to say that, since they participated in the drafting, anything they do reflects the intent of Congress. However, if a change was intended, it would seem that the District officials would have at some point in the legislative process spoken out on the matter.

of the net income derived by the petitioner from that segment of its business which consisted of the manufacture without, and sale [illegible]he products within the District. The percentage [illegible]us determined was out of all reasonable proportion to the trade or business carried on or engaged in by petitioner within the District."

It seems evident that the first sentence of this finding is the premise for the second, which latter, standing alone and undisturbed, would take the taxpayer here beyond the reach of the taxing statute. The premise in this instance, although stated in factual terms, appears to us to reflect the faulty reading of the statute which we have discussed at length immediately hereinabove. In other words, the premise assumes that the net income to be apportioned is only that derived from transactions which touch upon the District of Columbia, as distinct from the total net income of General Motors from its operations at large, including those physically related to the District of Columbia.

To the extent, therefore, that No. 6 is a true finding of fact, it rests upon an erroneous view of the applicable law; and, therefore, we do no violence to sound principles of appellate review when we conclude that this finding does not dictate our decision. We need not demonstrate that the particular fact found is untrue if it is irrelevant.

IV

Our inquiry, however, is not finished with the determination that the District Code permits the tax formula in use. We turn to the claim that the single-factor sales formula violates the due process clause by unreasonably apportioning income which properly has no relation to business done in the District, and the commerce clause by imposing an excessive burden of taxation.

That a single-factor formula is not inherently arbitrary or unreasonable is too well-settled to be subject to doubt at this late date.[25] Nor is this controverted by the holdings in other cases that multi-factor formulas are also constitutional.[26] The question remains, however, whether as to this taxpayer the tax is arbitrary and unreasonable. The burden of showing this is on the taxpayer; and the burden is a heavy one. "One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed." *Butler Bros* v. *McColgan*, 315 U.S. at 307. General Motors concedes that it was subject to taxation by the District. The company has not sustained its burden of showing that the tax levied on it, as determined by the single-factor sales formula, was "not reasonably attributable"[27] to the business transacted in the District so as to result in the taxation of extraterritorial values.

The evidence offered by General Motors in the Tax Court showed that only a small percentage of its property and payroll was located in the District. On the basis of testimony given by the economist-witnesses that, from an economic standpoint, income must be spread across the entire manufacturing process which precedes the ultimate sale in order to reflect the points where that income was actually "earned," the Tax Court found that a three-factor

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[25] *Smoot Sand & Gravel Corp.* v. *District of Columbia, supra; Eastman Kodak Co.* v. *District of Columbia, supra; Panitz* v. *District of Columbia, supra; Ford Motor Co.* v. *Beauchamp*, 308 U.S. 331 (1939); *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Comm'n*, 266 U.S. 271 (1924); *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920).

[26] *Northwestern States Portland Cement Co.* v. *Minnesota, supra; International Harvester Co.* v. *Evatt*, 329 U.S. 416 (1947); *Butler Bros.* v. *McColgan*, 315 U.S. 501 (1942); *United States Glue Co.* v. *Town of Oak Creek*, 247 U.S. 321 (1918).

[27] *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123, 133 (1931).

formula must be utilized to reflect accurately the income taxable in the District. With this finding, General Motors now contends that it has met the burden of showing the tax "not reasonably attributable" to its business conducted in the District. We disagree. An analysis of Supreme Court decisions illustrates that proof that a tax is not in reasonable proportion to business conducted must be much more detailed and specific than that adduced here.

In *Underwood Typewriter Co.* v. *Chamberlain, supra,* the Supreme Court held that the taxpayers had not sustained their burdens of showing that the taxes involved were arbitrary and unreasonable. The State of Connecticut imposed a tax on net income based on a single-factor property formula, which resulted in a tax on forty-seven per cent of Underwood's income. Underwood relied upon a showing that most of its receipts were from sales made outside the State:

> "But this showing wholly fails to sustain the objection. The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other States. In this it was typical of a large part of the manufacturing business conducted in the State. The legislature in attempting to put upon this business its fair share of the burden of taxation was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders. It, therefore, adopted a method of apportionment which, for all that appears in this record, reached, and was meant to reach, only the profits earned within the State." [28]

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[28] 254 U.S. at 120-21. The burden which *Underwood* failed to carry was " 'showing that 47 per cent of its net income [was] not reasonably attributable, for purposes of taxation, to the manufacture of products from the sale of which 80 per cent of its gross earnings was derived after paying manufacturing costs.' " *Ibid.*

The taxpayer in *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Comm'n., supra,* engaged in brewing (done wholly in England) and

It should be noted that in this quotation the Supreme Court accepted the economic theory here advanced by General Motors, namely, that "[T]he profits were largely earned by a series of transactions beginning with manufacture . . . and ending with sales. . . ." The theory proved the case in *Underwood* no better than it does here.

The case most strongly relied on by General Motors in its constitutional argument does not closely resemble the one before us. In *Hans Rees' Sons, Inc. v. North Carolina, supra*, the Supreme Court held that a North Carolina income tax based upon a single-factor property formula was arbitrary and unreasonable as applied to the taxpayer, who was engaged in the manufacture and sale of leather goods. In this case the Supreme Court was confronted with this characterization of the evidence by the North Carolina Supreme Court:

> "Without burdening this opinion with detailed compilations set out in the record, the evidence offered by the petitioner tends to show that for the years 1923, 1924, 1925, and 1926, the average income having its source in the manufacturing and tanning operations within the State of North Carolina was seventeen per cent." (quoted at p. 127 of 283 U.S.).

At the same time, the evidence showed that, for the same year, the percentage of the taxpayer's total net income apportioned to North Carolina by the formula in question

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selling ale, some of which was sold in New York through branch offices, also failed to meet its burden of showing that the New York franchise tax was unreasonable as applied to it.

> ". . . [A]s the Company carried on the unitary business of manufacturing and selling ale, in which its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places—the process of manufacturing resulting in no profits until it ends in sales—the State was justified in atrributing to New York a just proportion of the profits earned by the Company from such unitary business."

266 U.S. at 282.

averaged eighty percent. Accepting these facts as found by the state court, and setting the resulting sets of figures against each other, the Supreme Court stated:

> ". . . [I]n any aspect of the evidence, . . . the statutory method, as applied to the appellant's business for the years in question operated unreasonably and arbitrarily, in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted by the appellant in that State. In this view, the taxes as laid were beyond the State's authority."[29]

Unlike the proof adduced in *Hans Rees' Sons*, the evidence here did not undertake to show that the District of Columbia operations accounted for an identified percentage of General Motors total net income, which percentage could, as in *Hans Rees' Sons*, be compared with that taxed under the single-factor formula. The testimony offered by General Motors was largely that of economists who described the unitary character of the manufacturing and selling operations as respects the generation of profits, and who urged the three-factor formula as the one most likely to attribute a fair share of these profits to the District activities. Economic experts offered by the District dissented from this latter view, and insisted that the one-factor sales formula was a reasonable choice among alternative methods. Nowhere in the record do there appear specific percentages of the kind accepted by the Supreme Court in *Hans Rees' Sons*. That case, therefore, does not compel the decision in this; and, indeed, the evidence in the present record leaves us in the position in which the Supreme Court found itself in *Underwood Typewriter* and *Bass*.

"[T]he economic wisdom of state net income taxes is one of state policy not for our decision. . . ."[30] Indeed,

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[29] 283 U.S. at 135-136.

[30] *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. at 462.

there is no unity of agreement even among economists as to the factors which should be used or the weight each should be given in a reasonably accurate formula for state taxation of multi-state business.[31] Quite obviously, this court has no sound basis for ruling that one formula rather than another must be followed as the only legally permissible one, in the absence of a tangible demonstration, as in *Hans Rees' Sons*, that the formula under attack is operating indefensibly. The demonstration itself conceivably might take different forms, but each must reveal some concrete circumstance by which arbitrariness and irrationality, in the constitutional degree, may be identified.

V

The second constitutional attack by General Motors on the District's formula is based on an asserted violation of the commerce clause. A state-imposed income tax on a corporation which operates in interstate commerce does not violate the commerce clause merely because of that fact. The tax may be invalid if the corporation engaged "exclusively" in interstate commerce, with no local intrastate business. *Spector Motor Service, Inc.* v. *O'Connor*, 340 U.S. 602 (1951). Or it may be invalid if it discriminates against interstate commerce "either by providing a direct commercial advantage to local business, *Memphis Steam Laundry* v. *Stone*, 342 U.S. 389 (1952) . . . [*cf. Halliburton Oil Well Cementing Co.* v. *Reily*, 373 U.S. 64 (1963)], or by subjecting interstate commerce to the burden of 'multiple taxation,' *Michigan-Wisconsin Pipe*

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[31] See Barber, *State Taxation of Net Income Derived from Interstate Commerce*, 48 A.B.A.J. 1133 (1962), and Britton, *State Taxation of Extraterritorial Value; Allocation of Sales to Destination*, 46 VA. L. REV. 1160 (1960), both of whom criticize the inclusion of a sales factor in an apportionment formula. For a short history of the varying proposals by tax experts for more perfect apportionment, see RATCLIFF, INTERSTATE APPORTIONMENT OF BUSINESS INCOME FOR STATE INCOME TAX PURPOSES, pp. 17-28 (1962).

Line Co. v. *Calvert*, 347 U.S. 157 (1954). . . ."[32] However, a tax which is fairly apportioned to local activities, and is non-discriminatory, is a valid exercise of the State's taxing powers. "While it is true that a State may not erect a wall around its borders preventing commerce an entry, it is axiomatic that the founders did not intend to immunize such commerce from carrying its fair share of the costs of the state government in return for the benefits it derives from within the State." *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. at 461-62.

General Motors bases its commerce clause argument only on the ground that the District's single-factor formula discriminates against interstate commerce by resulting in unconstitutional double taxation of its income. It is undisputed that, as found by the Tax Court, the vehicles sold to customers in the District were manufactured largely in Michigan, Maryland, and Delaware. In the taxable years in question, General Motors paid these States a tax based on its net income, apportioned by each State on the basis of a three-factor formula of property, payroll, and sales, equally weighted.[33] This, of course, is the formula advocated in this case by the company.

As with the due process contention, the burden is on General Motors to show by specific evidence that "double taxation" would result from the application of the District's formula. This it has failed to do. The company has

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[32] *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. at 458.

[33] The taxes paid were:

Year	*State*	*Amount*
1957	Michigan	$8,955,799.55
1958	Michigan	6,940,309.50
1957	Maryland	510,792.31
1958	Maryland	271,425.75
1958	Delaware	127,844.95

produced only a hypothetical situation to prove its case: "Assume that Chevrolet has a net income of $3,000,000 derived from the manufacture and sale of automobiles sold to customers located in the District; that three-fourths of the manufacturing activity takes place in Michigan and one-fourth (including the activities of the zone or 'sales' office) takes place in Maryland. Michigan would tax 50% of the income (one-third of 75% property, 75% payroll, 0% of sales); Maryland would tax 16⅔% (one-third of 25% property, 25% payroll, 0% sales); and the District would tax 100% (sales alone). Chevrolet is taxed by the three states combined on 166⅔% of its total income."

Aside from the economic arguments that the income from these sales were attributable to operations in jurisdictions outside the District, no showing was made that the relatively minor portions of sales were not reasonably attributable to the concededly relatively minor scope of operations in the District. This court recognized in *Broadcasting Publications, Inc.* v. *District of Columbia* that exactitude is not possible in apportionment formulas:

> "In allocating Taxpayer's income for franchise tax purposes, neither the statute nor the Regulations attempt to determine what precise percentage of the income is attributable to each separate facet of the publication process and then allocate it geographically. That is unrealistic if not impossible." [34]

Secondly, and perhaps more importantly, the uniformity produced by the use of similar factors is more apparent than real. General Motors has pointed to only one facet of the apportionment process by which the tax

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[34] —— U.S.App.D.C. ——, ——, 313 F.2d 554, 559 (1962). See also *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. at 121, where the Supreme Court referred to "the impossibility of allocating specifically the profits earned by the processes conducted" within the borders of the taxing state.

structures of Michigan, Maryland, and Delaware, are similar to each other, and dissimilar to the District's structure. That facet consists of the factors which each uses to apportion business income to the respective states. However, the methods used to arrive at the portion of each factor which is attributable to the particular state are at least as important as the factors themselves in determining whether or not tax structures are similar. Similarity may or may not exist in the definition of local sales, the accounting procedures used, and the deductions permitted from gross income in order to arrive at net income.[35] In short, General Motors has not shown that the District's single-factor sales formula would impose a burden of double taxation.

> "Logically it is impossible, when the tax is fairly apportioned, to have the same income taxed twice. In practical operation, however, apportionment formulas being what they are, the possibility of the contrary is not foreclosed . . . . There is nothing to show

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[35] See Studenski, *The Need for Federal Curbs on State Taxes on Interstate Commerce: An Economist's Viewpoint*, 46 VA. L. REV. 1121 (1960); Barber, *supra*, note 31, at 1135. RATLIFF, *op. cit. supra* note 31, at 29-31, states:

> "Uniformity does not exist to the degree, however, that the [similarity of factors used] may suggest, for the factors are defined variously by the states. For example, among the locations to which sales are assigned are the locations of the following: office where negotiated, property at time of order, receipt or acceptance of order, negotiating personnel, point of delivery, and origin of shipment. Among the bases for allocating payrolls are: office location, time spent in the state, and compensation earned in the state.
>
> Generally the states provide for the direct allocation of certain types of income, such as capital gains, rents, royalties, dividends, and interest. However, 6 of the [states imposing a net income tax] make no provision for the direct allocation of any income. Usually states allow separate accounting in cases where the taxpayer shows that it more clearly reflects the income attributable to the state than does the formula, but again there are 6 that do not allow it."

that multiple taxation is present. We cannot deal in abstractions. In this type of case the taxpayers must show that the formula places a burden upon interstate commerce in a constitutional sense. This they have failed to do." [36]

VI

Nothing that we have said should be taken to mean that the single-factor sales formula is the *only* permissible formula which the District Commissioners might adopt under the authority committed to them by Congress in the taxing statute. Our holding is only that neither the District Code nor the Constitution *prevents* the use of the present formula of apportionment. On March 22, 1961, the Finance Officer of the District recommended to the Commissioners that they adopt the same three-factor formula which General Motors here advocates. The District's Director of General Administration added his recommendation that the formula be approved. Adoption of the new formula would bring the District into line with the apportionment formulae now used by twenty-five of the thirty-seven States and the District of Columbia which levy taxes on or measured by net income.[37] The Finance Officer stated that the formula has been endorsed for use by all of the States on a uniform basis by a number of expert and informed groups. We have no reason to doubt the authority of the Commissioners to adopt a property-payroll-sales formula. What we said in *Smoot* is equally applicable to our holding in this case: "The value and situs of the corporation's property used in its operation could doubtless have been ruled to be a permissible factor in apportioning income . . . but to say that this would be

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[36] *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. at 462-63.

[37] These figures are found in RATLIFF, *supra* note 31, at 29-30. Not included in the author's computation, but added here, is the State of Michigan, which also employs a three-factor formula.

permissible does not demonstrate that it must be considered an indispensable factor." [38]

However, the judicial branch has neither the mandate nor the machinery to make the policy determinations implicit in the choice of an apportionment formula. This is a legislative responsibility which has been reposed by Congress in the District Commissioners, and its wise discharge necessitates the use of legislative methods of inquiry into, and resolution of, issues affecting the interests of the District, of which maximum tax revenue is but one. This court can deal only with the individual case as it arises, and once it is determined that a legislatively adopted formula is not prohibited by statute or the Constitution, our task is complete. As Mr. Justice Frankfurter has stated:

> "The complexity of the proposals of the [Civil Aeronautics] Board's Report—the items to be taken into account, the balance to be struck among them, the problem of giving the States their due without unfairly burdening an industry of vital national import—indicates how ill-adapted the judicial process is, as against the choices open to Congress, for dealing with these problems and how warily this Court should move within the limits of its own inescapable duty to act. The protection of interstate commerce against the burden of multiple taxation ought not to be left to litigation growing out of changes in the methods of taxation.
>
> "The immunities implicit in the Commerce Clause and the potential taxing power of a State can hardly be made to depend, in the world of practical affairs, on the shifting incidence of the varying tax laws of the various States at a particular moment. Courts are not possessed of instruments of determination so delicate as to enable them to weigh the various

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[38] *Smoot Sand & Gravel Corp.* v. *District of Columbia*, 104 U.S. App.D.C. at 298-99, 261 F.2d at 764-65.

factors in a complicated economic setting which, as to an isolated application of a State tax, might mitigate the obvious burden generally created by a direct tax on commerce.' *Freeman* v. *Hewitt*, 329 U.S. 249, 256."[39]

Having found that the single-factor sales formula employed by the District is permitted by the District Code, and not shown on this record to be violative of the Constitution, we hold that the franchise tax levied against the General Motors Corporation for the years 1957 and 1958 was a valid one. The decisions of the Disfrict of Columbia Tax Court are accordingly,

Reversed

DANAHER, *Circuit Judge*, dissenting: This court in *Smoot Sand and Gravel Corp.* v. *District of Columbia*[1] was urged to consider a three-factor formula consisting of manufacturing costs, business property located in the District and sales made here. But the opinion noted that no evidence had been offered to compel acceptance of that formula. Moreover, the petitioner had failed to show that an arbitrary and unreasonable result flowed from the regulation which directed the apportionment of net income by considering only sales. Thus we refused to say that the assessments were invalid and erroneous.

Here the Tax Court, after noting that most of the facts and the evidence based upon exhibits had been stipulated, further found:

"5. The segment of petitioner's business which was conducted both within and without the District of

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[39] *Braniff Airways, Inc.* v. *Nebraska State Bd. of Equalization & Assesment*, 347 U.S. 590, 606 (1954) (dissenting opinion).

[1] 104 U.S.App.D.C. 292, 298, 261 F.2d 758, 764 (1958), *cert. denied*, 359 U.S. 968 (1959).

Columbia consisted of the manufacture of a certain number of automobiles and kindred products without the District and the sale thereof to customers within the District. The net income from this segment of petitioner's business was earned by a series of transactions beginning with the manufacture of products in several states and ending with the sale to customers in the District. While the net income was not realized until sale, it was earned in part by manufacture of the products sold, including in addition to actual manufacture, procurement of material, financing, use of property and administration.

"6. The method used by the assessing authority of the District attributed to the District 100 per centum of the net income derived by the petitioner from that segment of its business which consisted of the manufacture without, and sale of the products within the District. The percentage thus determined was out of all reasonable proportion to the trade or business carried on or engaged in by petitioner within the District."

With *Smoot Sand and Gravel* before it, the Tax Court expressly found that the District's use of the single-factor sales formula had allocated to the District all of the petitioner's income, earned at all stages, although only certain final sales had occurred in the District. Thus the sales formula failed to apportion petitioner's income as the Code commanded where income from a sale within the District was actually earned "partly within and partly without" the District.

"If the trade or business of any corporation . . . is carried on or engaged in both within and without the District, the net income derived *therefrom* [that is, from *business* so carried on or engaged in both within and without the District] shall . . . be deemed to be income from sources within and without the District." D. C. CODE § 47-1580a (1961). (Emphasis added.)

The same section next provides that where net income is so derived, the *portion* subject to tax shall be determined under regulations prescribed by the Commissioners. Clearly the purpose of the statute is to reach only a "proper"—*i.e.*, an equitable and just—"portion" which shall be subject to tax. To that end, the Code authorized the Assessor to employ "any formula or formulas" provided by regulation "which, *in his opinion, should* be applied in order to *properly* determine the net income . . . subject to tax." (Emphasis added.) The language speaks in terms of what is right and reasonable and just and equitable according to the facts. At least that much is required to save the tax from becoming an invalid imposition. The Assessor is not empowered broadly to utilize "any formula," but only one which "should" be utilized that the amount of tax be "properly" determined. And we have so held:

> "It seems clear from the statutory provisions considered as a whole that the Assessor is vested with discretion to select the most appropriate formula from among those set out in the regulations. Where no appropriate formula appears in the regulations, we think he has authority to devise one which in his judgment will properly determine the net income subject to tax and the correct amount of the tax. His determination is of course subject to review in the courts." *District of Columbia* v. *Gallant Incorporated*, 110 U.S.App.D.C. 202, 204-05, 290 F.2d 745, 747-48, (1961).

Even if the Assessor shall have failed so to act, the Tax Court itself cannot be precluded for lack of a regulatory formula, from determining the income which is fairly apportionable to the District, we said. Accordingly, we remanded the case to the Tax Court, thus:

> "The Tax Court is directed to determine the amount of the income which is fairly attributable to the District by applying the August 6, 1953, regulations, in-

cluding if necessary the use of such formula or formulae as the Tax Court deems best suited for determination of that question in this case." 110 U.S.App. D.C. at 205, 290 F.2d at 748.

It does not do for the majority simply to say that as to *some* corporations and in *some* situations a single-factor formula may validly be utilized.[2] Nor is it an answer to *this* taxpayer's contentions that the records in *some* cases have shown no more than that the single-factor formula has not resulted inequitably. We are here dealing with a record which overwhelmingly sustains the Tax Court's findings. I deem its conclusion inescapable that the single-factor sales formula utilized by the Assessor was here proved to be arbitrary and inequitable in its result, and therefore not consistent with the requirement of the Code. Having reached that conclusion, the Tax Court did precisely what we said should be done to determine an *equitable* tax. Agreeably to the *Gallant* directive, *supra*, the Tax Court applied "such formula or formulae as the Tax Court deems best suited for determination of [the petitioner's net income] in this case."

Consistently with what we had said was its duty to use the formula best suited to the determination required by the Code, the Tax Court turned to the three-factor formula substantially as set forth in the Uniform Division of Income for Tax Purposes Act.[3] The Tax Court's decision noted that the parties had stipulated facts sufficient

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[2] See, e.g., District of Columbia v. Gallant Incorporated, 113 U.S.App.D.C. 92, 305 F.2d 761 (1962). After our remand in the first Gallant case, text *supra*, the Tax Court found the sales formula best suited in the circumstances. We affirmed the result as just and reasonable even as we observed that the sales test is not the only or necessarily the best test. Other factors may be equally or even more relevant, we noted.

[3] Approved 1957, by the National Conference of Commissioners on Uniform State Laws and by the American Bar Association; and see *State Taxation of Net Income Derived from Interstate Commerce*, 48 A.B.A.J. 1133 (December 1962).

for the application of that formula. A study of the findings not only bears out that conclusion, but in my view, necessarily impels a rejection of the single-factor sales formula *as here applied.* I would affirm the Tax Court's decision.[4]

WILBUR K. MILLER and BASTIAN, *Circuit Judges*, concur in the foregoing dissenting opinion.

BURGER, *Circuit Judge, concurring in part and dissenting in part*: I agree with the majority that the Tax Court is probably without power to construct a three-factor formula to be substitute for the one-factor formula used by the Assessor. That the Tax Court's formula makes sense and the Assessor's does not is not the issue; rather it is a matter of where the power resides. I join with the dissent in viewing the Assessor's action as arbitrary and I would go further and hold that it is legally arbitrary and capricious, and hence violative of the statute under which the District purported to act. I would remand to require a reassessment of the tax, precluding the use of the one factor formula. Concluding that the Assessor's action was violative of the statute, I need not now reach the issue whether it was also violative of any constitutional protections.

---

[4] The Finance Officer on March 22, 1961 recommended that the Commissioners adopt the three-factor formula as "the most accurate and equitable method yet devised for apportioning among the States the taxable net income of corporations operating in a number of States." The Commissioners on March 28, 1961 approved the proposed amendments to the regulations with such amendments as might appear necessary after public hearing, all to become effective as of January 1, 1962. With this case impending, final action seems to have been postponed.

APPENDIX D

[Caption omitted]

On Petitions for Review of Decisions of the District of Columbia Tax Court.

Before: Bazelon, Chief Judge, and Wilbur K. Miller, Fahy, Washington, Danaher, Bastian, Burger, Wright and McGowan, Circuit Judges, sitting *en banc*.

JUDGMENT

These cases came on to be reheard en banc on the record from the District of Columbia Tax Court, and were reargued by counsel.

ON CONSIDERATION WHEREOF, it is ordered and adjudged by this court that the decisions of the Tax Court on review herein are reversed, and these cases are hereby remanded to the District of Columbia Tax Court for proceedings not inconsistent with the opinion of this court.

It is further ORDERED by the court that petitioner recover from respondent its taxable costs in these cases.

Per Circuit Judge McGowan.

Dated: February 13, 1964.

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

[Caption omitted]

ON PETITION FOR MODIFICATION OF JUDGMENT

Filed May 7, 1964

Before: BAZELON, Chief Judge, WILBUR K. MILLER, FAHY, WASHINGTON, DANAHER, BASTIAN, BURGER, WRIGHT and MCGOWAN, *en banc*.

PER CURIAM: In the prior opinion of this court in these cases, it was stated at page seven of the slip opinion that:

> "General Motors paid the assessment under protest, and appealed to the Tax Court. In that court, two primary arguments were urged as to the invalidity of the assessed deficiencies; one, that the numerator of the sales formula was too broad, in that it included sales which were not 'District sales'; and, two, that use of the single factor apportionment formula itself was permitted neither by the District Code nor by the Constitution."

On page eight this court stated that:

> "For the purposes of this appeal, [General Motors] appears to concede the correctness of the figures found by the Tax Court as representing 'District sales'. The controversy before us, therefore, does not relate to the definition of what sales by General Motors may properly be taken to be 'District sales', made in the course of a business activity which is carried on both within and without the District. It relates, rather, to the formula to be used for apportioning to the District that part of General Motors entire net income attributable to its 'District sales'."

General Motors has petitioned for a modification of this court's judgment to the limited extent of remanding the cases to the Tax Court for consideration of the application of the regulation embodying the single-factor formula to the facts. It is said that, since the Tax Court found that regulation invalid and proceeded to apply one of its own, there was never any adjudication of the contentions made by the taxpayer as to the proper scope of the application of the former to its D. C. operations. There having been no ruling on these contentions, adverse or otherwise, there was, of course, nothing to be made the subject of an appeal, or to be waived, by the taxpayer.

We find this request to be meritorious and, indeed, consistent with the above-quoted passages from our prior opinion. We are also satisfied from an examination of the record that this issue was not stipulated away by General Motors. General Motors is, it seems to us, entitled to press, and to have resolved, its contentions with respect to the proper determination of "District sales" for purposes of a one-factor formula regulation which we, unlike the Tax Court, have found to be valid.

The petition is, accordingly, granted; and our earlier judgment is modified to the extent of providing that the reversal of the Tax Court decisions is to be accompanied by remand to the Tax Court for such further proceedings as are not inconsistent herewith.

It is so ordered.

WILBUR K. MILLER, DANAHER and BASTIAN, *Circuit Judges*, dissenting: Even as modified the majority opinion remains unacceptable to us. We adhere to the position more fully stated in our original dissent.

APPENDIX F

[Caption omitted]

Before: BAZELON, Chief Judge, and WILBUR K. MILLER, FAHY, WASHINGTON, DANAHER, BASTIAN, BURGER, WRIGHT, and MCGOWAN, Circuit Judges, in Chambers.

ORDER

On consideration of respondent's petition for modification of this Court's judgment of reversal, dated February 13, 1964, of the opposition thereto by the District of Columbia, and of respondent's reply, it is

ORDERED by the Court that respondent's aforesaid petition for modification is hereby granted.

Per Curiam.

Dated: May 7, 1964

Circuit Judge Burger did not participate in the forgoing order.

APPENDIX G

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

1. UNITED STATES CONSTITUTION:

Art. I, Sec. 8, clause 3:

"The Congress shall have Power—

* * * *

"To regulate Commerce * * * among the several States, * * *;"

Fifth Amendment:

"No person shall * * * be deprived of life, liberty or property, without due process of law; * * *."

2. DISTRICT OF COLUMBIA INCOME AND FRANCHISE TAX ACT OF 1947, Act of July 16, 1947, 61 Stat. 328, ch. 258, as amended by Act of May 3, 1948, 62 Stat. 206, ch. 246:

Sections 1 and 2, Article I, Title X (Sections 47-1580 and 47-1580a, D.C. Code, 1961):

"Sec. 1. PURPOSE OF ARTICLE.—It is the purpose of this article to impose (1) an income tax upon the entire net income of every resident and every resident estate and trust, and (2) a franchise tax upon every corporation and unincorporated business for the privilege of carrying on or engaging in any trade or business within the District and of receiving such other income as is derived from sources within the District: *Provided, however,* That in the case of any corporation, the amount received as dividends from a corporation which is subject to taxation under this article, and, in the case of a corporation not engaged in carrying on any trade or business within the District, in-

terest received by it from a corporation which is subject to taxation under this article shall not be considered as income from sources within the District for the purpose of this article. The measure of the franchise tax shall be that portion of the net income of the corporation and unincorporated business as is fairly attributable to any trade or business carried on or engaged in within the District and such other net income as is derived from sources within the District: *Provided further*, That income derived from the sale of tangible personal property by a corporation or unincorporated business not carrying on or engaging in trade or business within the District as defined in title I of this article shall not be considered as income from sources within the District for purposes of this article, with the exception of income from sales to the United States not excluded from gross income as provided in title III, section 2(b)(13) of this article."

"Sec. 2. ALLOCATION AND APPORTIONMENT. —The entire net income of any corporation or unincorporated business, derived from any trade or business carried on or engaged in wholly within the District shall, for the purposes of this article, be deemed to be from sources within the District, and shall, along with other income from sources within the District, be allocated to the District. If the trade or business of any corporation or unincorporated business is carried on or engaged in both within and without the District, the net income derived therefrom shall, for the purposes of this article, be deemed to be income from sources within and without the District. Where the net income of a corporation or unincorporated business is derived from sources both within and without the District, the portion thereof subject to tax under this article shall be determined under regulation or regulations prescribed by the Commissioners. The Assessor is authorized to employ any formula or formulas pro-

vided in any regulation or regulations prescribed by the Commissioners under this article which, in his opinion, should be applied in order to properly determine the net income of any corporation or unincorporated business subject to tax under this article."

3. DISTRICT OF COLUMBIA INCOME AND FRANCHISE TAX REGULATIONS, as promulgated August 6, 1953 and relettered by amendment of July 24, 1956:

"Sec. 10-2(c). *Income Attributed to the District of Columbia.* If the trade or business is carried on or engaged in wholly within the District, the entire net income from trade or business shall be allocated to the District. If the trade or business is carried on partly within and partly without the District, that portion of the net income from trade or business to be apportioned to the District shall be determined as follows:

"(1) Income from sales of tangible personal property.

(a) Where income for any taxable year is derived from the manufacture and sale or purchase and sale of tangible personal property, the portion thereof to be apportioned to the District shall be such percentage of the total of such income as the District sales made during such taxable year bear to the total sales made everywhere during such taxable year. Every corporation and unincorporated business which carries on or engages in business in the District within the meaning of the words 'trade or business' as defined in the Act is, unless specifically exempted by some provisions of the Act, subject to tax. For the purpose of this regulation, the phrase 'District sales' shall mean all sales to District customers the income from which is fairly attributable to the trade

or business carried on or engaged in within the District, including solicitation in the District by salesmen or other representatives of the taxpayer, that portion of sales to customers outside the District the income from which is fairly attributable to the trade or business carried on in the District, and sales of tangible personal property the income from which is from District sources."

APPENDIX H *

	1957			1958		
	Single Factor	Two Factor	Three Factor	Single Factor	Two Factor	Three Factor
	Destination Sales	(1) Gross Owned and Rented Property (2) Payroll	(1) Gross Owned and Rented Property (2) Payroll (3) Destination Sales	Destination Sales	(1) Gross Owned and Rented Property (2) Payroll	(1) Gross Owned and Rented Property (2) Payroll (3) Destination Sales
Apportionable Income	$1,312,092,839	$1,312,092,839	$1,312,092,839	$653,396,893	$653,396,893	$653,396,893
Apportionment Percentage	.3930%	.0348%	.1542%	.4144%	.0366%	.1625%
Apportioned Income	5,156,525	456,608	2,023,247	2,707,677	239,143	1,061,769
Income Directly Allocated	10,320	10,320	10,320	15,418	15,418	15,418
Taxable Income	$ 5,166,845	$ 466,928	$ 2,033,567	$ 2,723,095	$ 254,561	$ 1,077,187
Rate of Tax	.05	.05	.05	.05	.05	.05
Tax	$ 258,342.25	$ 23,346.40	$ 101,678.35	$ 136,154.75	$ 12,728.05	$ 53,859.35

Computation of Apportionment Percentage:

1. Gross Owned and Rented Property								
(a) In District—								
Gross Owned	$ 378,476				$ 347,025			
Rented (rent x 8)	982,200				979,184			
Total	$ 1,360,676				$ 1,326,209			
(b) Everywhere—								
Gross Owned	$6,146,870,978				$6,295,491,112			
Rented (rent x 8)	100,289,392				108,182,464			
Total	$6,247,160,370				$6,403,673,576			
Percentage (a) ÷ (b)	.0218%		.0218%	.0218%	.0207%		.0207%	.0207%
2. Payroll								
(a) In District	$ 1,268,180				$ 1,233,787			
(b) Everywhere	2,662,072,037				2,354,049,741			
Percentage (a) ÷ (b)	.0477%		.0477%	.0477%	.0524%		.0524%	.0524%
3. Sales								
(a) To District Customers	$ 37,185,704				$ 32,542,519			
(b) To All Customers	9,461,855,874				7,853,393,381			
Percentage (a) ÷ (b)	.3930%	.3930%		.3930%	.4144%	.4144%		.4144%
Total Percentages		.3930%	.0695%	.4625%		.4144%	.0731%	.4875%
Average Percentage		.3930%	.0348%	.1542%		.4144%	.0366%	.1625%

* Stipulated data (R. 465-9, 470e-470f, 477-81) and computations based thereon.

MOTION FILED
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SUPREME COURT, U. S.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. 352

GENERAL MOTORS CORPORATION, *Petitioner,*

v.

DISTRICT OF COLUMBIA, *Respondent.*

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF AMICUS CURIAE OF ASSOCIATED INDUSTRIES OF NEW YORK STATE, INC. IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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Pursuant to Rule 42 of the Rules of the Supreme Court of the United States, Associated Industries of New York State, Inc. respectfully moves this Court for leave to file the accompanying brief in support of the petition by General Motors Corporation for a writ of *certiorari* in the instant case. Counsel for petitioner has stated that petitioner consents to the filing of this brief, but counsel for the respondent has refused.

Associated Industries of New York State, Inc. has since its founding in 1914 served as the "voice of industry" in the nation's largest industrial state. The association has approximately 1400 member companies having offices and plants in every part of the State of New York. Both manufacturing and non-manufacturing companies, representing total business activity of many billions of dollars annually, are included within the membership.

A great many members of the association manufacture goods in New York which are then sold to customers in the District of Columbia as well as to customers throughout the 50 states. For the years in question, 1957 and 1958, an informal survey of a small but representative group of member companies engaged in manufacturing revealed that a majority of them made sales to customers in the District of Columbia. Sales to such customers made by companies in the small group surveyed amounted to approximately $100,000,000 in each year.

The State of New York imposed a franchise tax measured by net income during the years in question and the sales of goods manufactured in New York and sold to customers in the District were included in the tax base in New York. The interpretation in the instant case by the Court of Appeals for the District of Columbia of the District of Columbia Corporation Income and Franchise Tax Act and of the regulations promulgated thereunder means that these same sales, taxed by the State of New York under its apportionment formula, are now taxable by the District of Columbia on 100% of the net income. Such an interpretation, if not overturned, constitutes an open invitation to other jurisdictions to enact similar one-factor

sales formulae, thus subsidizing intrastate business by burdening interstate commerce with discriminatory and multiple taxation.

The Applicant association thus has an interest in this case by reason of the substantial effect of the decision of the Court of Appeals for the District of Columbia upon its member companies, not only with respect to their commerce into the District of Columbia but also into other jurisdictions as well. The Applicant wishes to clarify the presentation of the important statutory and constitutional questions presented by this petition for *certiorari* as they relate to its members and to show the far-reaching effect of this decision on the interstate commerce of a substantial segment of American industry.

Respectfully submitted,

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IN THE

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OCTOBER TERM, 1964

No. 352

GENERAL MOTORS CORPORATION, *Petitioner*,

v.

DISTRICT OF COLUMBIA, *Respondent*.

BRIEF AMICUS CURIAE OF ASSOCIATED INDUSTRIES OF NEW YORK STATE, INC.

QUESTIONS PRESENTED

1. Whether the single-factor sales formula for apportionment of net income prescribed by the Commissioners of the District of Columbia purportedly under authority of the District of Columbia Income and Franchise Tax Act of 1947 violates the due process clause of the 5th Amendment to the Constitution or the commerce clause of the Constitution where the application of the formula results in taxation by the District of 100% of the net income of a foreign corporation derived from the manufacture and sale of products without the District to customers within the District.

2. Whether the adoption by regulation of the District Commissioner of a single-factor sales formula which allocates to the District 100% of the net income from the manufacture and sale of products without the District to customers within the District is permitted by the District of Columbia Income and Franchise Tax Act of 1947.

ARGUMENT

Your Applicant views this case as one of signal importance in the harmonization of competing demands by the various taxing jurisdictions, including the District of Columbia, upon unitary manufacturing and selling concerns doing an interstate business.

This Court in *Northwestern States Portland Cement Company* v. *Minnesota,*[1] has established that states may tax the net income of exclusively interstate commerce where a sufficient nexus is established provided the net income is "fairly apportioned." Some 38 states and 95 municipalities now impose taxes on, or measured by, net income of corporations.[2] New York can be counted within this group.[3] While many of these jurisdictions have adopted apportionment formulae fairly similar to the three-factor formula approved in *Northwestern States Portland Cement Company, supra,* others have devised formulae of their

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[1] 358 U.S. 450 (1959).

[2] "State Taxation of Interstate Commerce," Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the House of Representatives, pursuant to P.L. 86-272, as amended, H.R. Rep. No. 1480, 88th Cong., 2d Sess. 99, 447 (June 15, 1964).

[3] Id., p. 103; McKinney's Consolidated Laws of New York, Ch. 60, Art. 9-A, Sections 208-210 (1954).

own.[4] The possibility of discrimination against and burden upon interstate commerce as a result of the inter-relationships of varying formulae quite obviously was foreseen by this Court when it required net income to be "fairly apportioned." While this Court has given some indications of the general outlines of fair apportionment,[5] it has not had before it a case sufficiently blatant to set the outer bounds of constitutionality of an apportionment method. The instant case offers the Court such an opportunity.

The effect of the decision of the Court of Appeals for the District of Columbia in this case is to permit a state or municipality where an interstate manufacturer and seller's customers are located to tax the entire net income of the interstate taxpayer arising from sales to customers in the taxing jurisdiction even though the interstate manufacturer and seller's principal operations take place outside such jurisdiction. If allowed to stand, this decision can only serve as an open invitation to many states and municipalities to impose a tax on the entire income from all sales to their inhabitants. The temptation to tax the foreign corporation while subsidizing domestic manufacturers would be almost irresistible and the result would be obvious

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[4] Id., pp. 168-192. New York's formula, for example, for the years in question was a more complicated version of the *Northwestern States'* formula. McKinney's Consolidated Laws of New York, Ch. 60, Art. 9-A, Sections 208-210 (1954). Approved in *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U.S. 271 (1924).

[5] *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920); *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U.S. 271 (1924); *Butler Bros.* v. *McColgan*, 316 U.S. 501 (1942); *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450 (1959).

discrimination against interstate commerce. The prospect of cumulative multiple taxation on the same income is equally obvious. The undesirable results which would flow from the decision of the Court of Appeals for the District of Columbia demonstrate either that the application of the statute as interpreted by the District Commissioners and the Court of Appeals is unconstitutional or that the interpretation of the statute is erroneous.

This Court has many times said that the commerce clause, the 5th Amendment and the 14th Amendment prevent imposition upon interstate commerce either of discriminatory taxation to which intrastate business is not subject or of the cumulative burdens of multiple taxation to which, again, intrastate business is not subject.[6] This Court has given tacit approval to a number of formulae for apportioning net income on the basis of multi-factor formulae including property, payroll and sales including several similar to that used by the State of New York.[7] If these latter formulae constitute "fair" apportionment, the District of Columbia one-factor sales formula cannot also be fair because it necessarily results in double taxation when goods sold are delivered to customers in the District from a stock in New York. This can be demonstrated quite easily

[6] The cases are collected and analyzed in the majority opinion of Mr. Justice Clark in *Northwestern States Portland Cement Co.* v. *Minnesota, supra,* at pp. 458-465. While the commerce clause does not restrict Congress in its power to legislate for the District, it does apply to the District Commissioner. *District of Columbia* v. *John R. Thompson Co.,* 346 U.S. 100, 107 (1953).

[7] *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission,* 266 U.S. 271 (1924); *West Publishing Company* v. *McColgan,* 328 U.S. 823 (1946); *Northwestern States Portland Cement Co.* v. *Minnesota, supra.*

by even a cursory reference to the New York statute. In 1957 and 1958, New York imposed a franchise tax on business corporations for the privilege of doing business in the State of New York.[8] The tax was basically measured by "entire net income" or the portion thereof allocable within the state. Entire net income was allocated to New York on the basis of a three-factor formula consisting of ratios of (a) average value of real and tangible personal property within the state to average value of such property everywhere, (b) gross receipts from the sale of tangible personal property located within the state and sales of property not within the state and not located at one of the taxpayer's permanent and continuous places of business outside New York if the order was received or accepted within the state plus other business receipts earned within the state to total receipts from all such items everywhere and (c) wages and personal compensation of employees within the state to such compensation everywhere. It is quite clear that New York includes in its tax base the net income from the sale of tangible personal property manufactured within the state and sold to District of Columbia customers. However, it is equally clear that New York weights the sales factor as only a part of the total business activity generating the entire net income.

On the other hand, the Court of Appeals' decision approving the single-factor sales formula of the District Commissioners' regulation allocates the entire net income from the sale of tangible personal property to a customer in the District by a unitary manufacturing

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[8] McKinney's Consolidated Laws of New York, Ch. 60, Art. 9-A, Sections 208-210 (1954).

and selling operation to the situs of the customer, specifically to the District. The District Commissioners appear to have pushed the fair apportionment concept to the breaking point. In fact, the single-factor sales formula is no apportionment at all. It is merely direct allocation of the entire net income to the situs of the customer. Paraphrasing Mr. Justice Clark's statement in *Northwestern States Portland Cement Co., supra,*

> "This is an unapportioned tax which by its very nature makes interstate commerce bear more than its fair share."

It is submitted that the regulation of the District Commissioners violates the spirit of the "fair apportionment" concept and should be struck down before other jurisdictions make the same attempt.

The second question presented is whether, aside from any constitutional problems raised by its decision approving the use of a single-factor sales formula, the Court of Appeals for the District of Columbia properly interpreted the District of Columbia Income and Franchise Tax Act of 1947. On this question, it is submitted that, as found by the District of Columbia Tax Court, the statute neither requires nor permits the use of a single-factor sales formula. Accordingly, to enforce the "fair apportionment" concept developed by this Court, it would not be necessary to invalidate the statute on constitutional grounds.

CONCLUSION

It is respectfully submitted that the issues presented in the instant petition for writ of *certiorari* involve substantial federal constitutional and statutory ques-

tions. This *amicus curiae*, therefore, urges the Court to grant a writ of *certiorari* herein.

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No. 352

IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

GENERAL MOTORS CORPORATION, *Petitioner*,

v.

DISTRICT OF COLUMBIA, *Respondent*.

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE AND BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. 352

GENERAL MOTORS CORPORATION, *Petitioner*,

v.

DISTRICT OF COLUMBIA, *Respondent*.

MOTION OF BETHLEHEM STEEL COMPANY FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR CERTIORARI

Bethlehem Steel Company hereby respectfully moves for leave to file a brief *amicus curiae* in this case. The consent of the Attorney for the Petitioner has been obtained. The consent of the Attorney for the Respondent was requested but refused.

The interest of the Bethlehem Steel Company in this case arises from the fact that it has pending before the District of Columbia Tax Court an appeal from a denial of a claim for refund of District of Columbia income and franchise tax for the period from October 1, 1958, to December 31, 1958. In addition, it has filed

claims for refund of such tax with respect to the years 1959 through 1960, and has filed a protest to the proposed assertion of a deficiency in such tax for the year 1961. The appeal filed by Bethlehem Steel Company, the claims for refund and the protest present the same issue as is presented in the instant case.

The Bethlehem Steel Company requests permission to file a brief *amicus curiae* in order to emphasize to the Court the importance of the resolution of the issue raised in the instant case to corporations other than Petitioner.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. 352

GENERAL MOTORS CORPORATION, *Petitioner*,

v.

DISTRICT OF COLUMBIA, *Respondent*.

BRIEF OF BETHLEHEM STEEL COMPANY IN SUPPORT OF PETITION FOR CERTIORARI

Bethlehem Steel Company, with leave of the Court, presents this brief in support of the petition for certiorari.

INTEREST OF AMICUS CURIAE

The interest of Bethlehem Steel Company is set forth in the accompanying Motion for Leave to File Brief Amicus Curiae.

ARGUMENT

In *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450 (1959), this Court made clear that the several states may tax constitutionally the net income of business enterprises derived exclusively from interstate commerce. In the course of the opinion, it

was several times emphasized that a concomitant of this power to tax was that such income be "fairly apportioned" among the several states. 358 U.S., at 460, 462. The Court explicitly noted that no question was raised in *Northwestern States* concerning the reasonableness of the apportionment formulas then before the Court or their practical operation. 358 U.S., at 452, 463.

Following this Court's decision, many segments of the business community expressed concern that the states would seek to expand their taxing jurisdiction to limits which had not as yet been defined by judicial opinion. Partly in response to this concern, Congress enacted in 1959 Public Law 86-272, 73 Stat. 555 (1959), 15 U.S.C. § 381 (Supp. IV, 1963), which (1) undertook to set forth minimal jurisdictional requirements under which the states could tax purely interstate net income, and (2) directed the appropriate Congressional committees to enter into a comprehensive study of the problems created by state taxation of interstate commerce.*

Fair apportionment among the states of interstate income derived from multistate operations is, of course, a far more serious and pressing problem since this Court's decision in *Northwestern States*. Double taxation is no longer an academic problem; it is now a reality which faces any corporation doing multistate business. It is caused by the growth of state statutes which impose a tax on interstate commerce, and by the

* In response to this statutory directive, a Special Subcommittee of the Committee on the Judiciary, House of Representatives, recently completed and published a Report on State Taxation of Interstate Commerce, H.R. No. 1480, 88th Cong., 2d Sess. (hereinafter referred to as the "House Report.")

many vagaries of apportionment formulas utilized by local taxing authorities. As the House Report stated (p. 118):

> "Not only have there always been wide diversities among the various formulas employed by the States, but the composition of those formulas seems to be constantly changing."

Both the majority and dissenting opinions in *Northwestern States* express the view that it remains the primary obligation of Congress, and not the judicial system, to set precise guidelines for the taxation of interstate commerce. 358 U.S., at 457-58, 476-77. One cannot dispute this conclusion. But it seems equally true that the judicial system—and, at its apex, this Court—cannot stand by in the absence of Congressional action and allow unconstitutional taxation to occur.

We recognize the truth of Mr. Justice Frankfurter's statement:

> "At best, this Court can only act negatively; it can determine whether a specific state tax is imposed in violation of the Commerce Clause." 358 U.S., at 476.

It is this essentially negative action—the striking down of those state attempts to tax beyond constitutional bounds—that we ask the Court to undertake in the present case.

The question which petitioner asks this Court to decide is simply this: Does the use by the District of a single factor sales formula—a formula which disregards other elements that this Court has found in other cases to contribute to the making of corporate profit—

create an unconstitutional tax where it has specifically been found by the trier of fact that (1) the same income produced by District sales has been taxed in the state of manufacture by attributing such income to the capital and labor employed in those states, thereby creating double taxation of the same income, and (2) that the income taxed by the District was grossly disproportionate to the activities of petitioner within the District.

Clearly this is not a case where there exists only a fear of disproportionate and double taxation because of the conflicting tax statutes of several jurisdictions; rather, petitioner has laid an ample factual basis for these findings made by the trier of fact.

This Court need go no further than it went more than 30 years ago in *Hans Rees' Sons* v. *North Carolina*, 283 U.S. 123 (1931), in order to reverse the judgment of the Court of Appeals for the District of Columbia. In that case, this Court struck down the application of a North Carolina tax which allocated income on the single factor of property within the taxing jurisdiction. This Court found that, "as applied to the appellant's business for the years in question [the tax] operated unreasonably and arbitrarily, in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted by appellant in that State." 283 U.S., at 135. An almost identical finding of fact has been made in the present case.

In addition, it has also been found that the same income has in fact been taxed by other jurisdictions—jurisdictions whose apportionment formulas accord more closely with corporate facts of life. The House

Report shows that while only two states in 1929 used apportionment formulas which recognized the joint contributions of property, payroll, and sales in the production of income, 26 states use such formulas today. (See Table 5-7, House Report p. 119.) This growing recognition by the states that fair apportionment demands recognition of several income-producing factors is most significant. This Court quite recently has relied on the evolution of state laws as a benchmark by which to measure a minimum standard of due process. *Mapp* v. *Ohio*, 367 U.S. 643, 651 (1961).

The Court, however, need not go so far as to declare unlawful the use of single factor sales formulas. All the Court need do is recognize that such a formula is at least suspect, because it fails to accord any weight to other elements in the production of income which most taxing jurisdictions have recognized over the years and which this Court specifically has found to be valid. And when such a single-factor formula in fact produces the disproportionate and double taxation which is likely to occur from its use, then—now—it is appropriate for this Court to declare such a tax unlawful.

Bethlehem fully shares the apprehension of petitioner that, if the present judgment is allowed to stand, it will offer an inducement to any state in which all of a taxpayer's customers are located to attempt to tax the entire net income of the taxpayer, regardless of the location of taxpayer's overall operations. The evils of such a situation are obvious: the arbitrary allocation of income surely denies the taxpayer due process, and the balkanization which would occur among the several states defeats the very purpose of the Commerce Clause. Uniformity achieved by Congressional action may be the future hope, but judicial intervention to

protect against unconstitutional burdens must be the present answer.

CONCLUSION

Bethlehem Steel Company joins with petitioner in respectfully urging this Court to grant the petition for a writ of certiorari and reverse the judgment below.

Respectfully submitted,

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STATUTES CITED

District of Columbia Income and Franchise Tax Act of 1947, 61 Stat. 328, ch. 258, as amended by the Act of May 3, 1948, 62 Stat. 206, ch. 246, and by Title IV, District of Columbia Revenue Act of 1949, 63 Stat. 112, ch. 146, and by Title XII of the District of Columbia Public Works Act of 1954, 68 Stat. 101, ch. 218; D. C. Code, 1961, § 47-1551 *et seq.* ---------- 1, 2, 10, 13, 16

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. 352

GENERAL MOTORS CORPORATION, *Petitioner*,

v.

DISTRICT OF COLUMBIA, *Respondent*.

On Petition for Writ of Certiorari to United States Court of Appeals for the District of Columbia Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

QUESTIONS PRESENTED

In the view of respondent, the questions presented are:

Where the Congress acting under its plenary power over the District of Columbia provided, in the District of Columbia Income and Franchise Tax Act of 1947, for the imposition of a franchise tax upon corporations engaged in trade or business in the District of Columbia to be measured by "that portion of the net income of the corporation and unincorporated business as is fairly attributable to any trade

or business carried on or engaged in within the District and such other net income as is derived from sources within the District," and where, pursuant to the act, the Commissioners of the District adopted regulations containing a formula for the apportionment of the income of corporations engaged in the District and elsewhere in selling personal property on the basis of the ratio which such sales in the District by the corporation bear to its sales everywhere, and where this method of apportionment was applied by the District to General Motors Corporation, was not the United States Court of Appeals for the District of Columbia Circuit, sitting en banc, correct in holding:

1. That the apportionment formula prescribed in the Commissioners' regulations for apportioning net income, is a valid formula under the District of Columbia Income and Franchise Tax Act of 1947 and, as such, applicable to General Motors Corporation?

2. That the Commissioners' apportionment formula is not violative of or in conflict with the Constitution or decisions of this Court, and that its application to petitioner does not apportion to the District of Columbia net income in excess of that attributable to petitioner's activities within the District?

COUNTER-STATEMENT OF THE CASE

General Motors Corporation's principal business is the manufacture and sale of automobiles, trucks, and other types of motor vehicles, and the parts, engines, and accessories therefor. Although it does not conduct manufacturing or assembling operations in the District, it maintains, within and without the District, offices and personnel for the conduct of its business, including selling and promoting in the District the sale of its various products. (R. 399-409.) General Motors' methods of doing business, including selling and distributing its products, are the same throughout the country, including the District of Columbia. (R. 400.)

General Motors, in addition to a central management staff, is organized into divisions operating substantially independent of each other, although none are separately incorporated. There are five car divisions. Four of these divisions (Pontiac, Buick, Oldsmobile, and Chevrolet) operated both in the District and elsewhere in a substantially identical manner in the promotion and sale by the divisions of automobiles, parts, and accessories. These divisions moved their merchandise through dealers under contract with General Motors which, with certain exceptions not material in this case, sold its products only to such dealers for resale by them. (R. 400-416.) The dealer agreements contained detailed recitations of the parties' obligations and responsibilities. Each contained provisions concerning prices to be paid for General Motors' products, the authority of the dealer to sell those products, delivery of the products by General Motors, the obligation of the dealer to maintain a satisfactory place of business and to remain in that place unless authorized to move, the maintenance by the dealer of General Motors' standards for capital and net worth, the maintenance by the dealer of accounting records as specified by General Motors, and the making of both financial and operating statements to that corporation monthly. The agreements further provided for rendition of satisfactory sales performance and satisfactory service to the purchasers of General Motors products, the maintenance of adequate records and personnel, as well as an adequate number and assortment of parts and accessories. Detailed provisions were included in the agreement for the termination of the agreement by General Motors, or by the dealer. (Pet. Ex. 4-b, 4-c; R. 430-33.)

The remaining car division, Cadillac, conducted its activities in a manner different from the other divisions, the principal difference being that Cadillac, instead of entering into agreements with dealers, appointed distributors for the merchandising of its products who, in turn, appointed dealers. (R. 416-22.)

During the years in question Pontiac Division had four Pontiac dealers in the District; Oldsmobile had five Oldsmobile dealers in the District; Chevrolet Motor Division had five Chevrolet dealers in the District; and Cadillac Motor Division had a distributor in the Disttrict, which distributor was also a retail Cadillac dealer. (R. 401, 410-14, 416-17.)

Although only Chevrolet maintained an office in the District, each of the other divisions, from nearby offices, continuously and regularly sent personnel into the District for the purpose of promoting the sale and selling General Motors' products, working with dealers and, in general, conducting within the District all activities requisite to the division's business in the District. Chevrolet's activities in this regard were similar in nature although carried on both from its District office as well as through personnel located in offices outside the District. (R. 400-416.)

With the exception of the Cadillac Division the operations of the car divisions, both in the District and elsewhere, typically are as follows:

The country is divided into regions, each of which is supervised by a regional manager. The regions are divided into zones and each zone has a zone manager who is directly in charge of the zone and responsible for the overall activity of the zone office. The zone manager and his assistant make periodic visits to the various dealers in the zone for the purpose of working with dealers and maintaining their interest in items which will help in the retail sales of automobiles by the dealers, as well as promoting the sale of promotional literature. Within the zone are a number of district managers who are responsible for carrying on with the dealers the same type of activities as do the zone manager and his assistant. There is also a business management manager within the zone, most of whose time is spent in assisting dealers within the zone in making their operations more profitable. Other personnel working with deal-

ers within the zone include a parts and services manager who performs multiple functions relating to assisting the dealer in maintaining proper inventories and in promoting service; a claims administrator with an assistant whose functions are the processing of complaints from customers and of dealers' claims pursuant to warranties; and service representatives whose activities are substantailly the same as those of the parts and services manager. (R. 400-416.)

General Motors maintains in Baltimore a parts division warehouse which fills orders of its dealers for parts, shipping such items directly to the dealer. In the case of Pontiac, the zone office maintains a stock of cars in warehouses outside the District, selling approximately 50 to 100 cars a month to dealers who themselves pick up the cars. (R. 403, 407.) Chevrolet Division has a fleet manager in Chevrolet's District of Columbia office whose function it is to contact local and national fleet users in the District and elsewhere supplying them technical information and promoting orders for vehicles to be placed by fleet customers with dealers. (R. 414.) In the case of Chevrolet dealers, orders are sent by the dealer directly to Chevrolet's office in Baltimore which also serves the District of Columbia, and whose personnel operate substantially the same as the personnel of the other car divisions, processing, *inter alia*, owners' complaints regarding service by District dealers, applications for dealerships, and other functions. (R. 411-16.)

The Cadillac Division has one distributor located in the District of Columbia, the only retail Cadillac outlet in the District. Cadillac Division's personnel maintain contact with distributors and, through the distributors, with Cadillac dealers. The functions of these personnel are substantially the same as the functions described for personnel of the other divisions. (R. 416-22.)

Among the operating divisions of General Motors is GMC Truck and Coach Division which operates in a man-

ner similar to that of the car divisions and which appoints dealers in various areas including the District of Columbia. This division manufactures vehicles and parts which are sold to dealers who, in turn, sell them to the public. Personnel of the division regularly visit the dealers for the purpose of promoting the sale of petitioner's products and assisting dealers in their operations, including the making of contacts with potential customers for the division's products. (R. 416-30.)

United Motors Service Division manufactures and sells parts and accessories to wholesalers. It maintains in the District a zone office with personnel whose function it is to promote the sale of the division's products through wholesalers. The district zone manager also has the function of making direct contact with customers of the wholesaler. This division's personnel function along lines similar to those of the car divisions. The division has seventeen wholesalers within the District, all of which are under written contract. (R. 446-50.)

The AC Spark Plug Division has an office in the District maintained for government contact purposes, but civilian items manufactured by the division are sold to customers in the District through other personnel who regularly travel to the District for the purpose of contacting the division's warehouse distributors who are under written contract with General Motors. These personnel promote sales and assist the dealers and other purchasers of the division's products. (R. 435-38, 450-56.)

Motors Holding Division, in its operation of financing dealers, receives all of the voting stock of a dealer and nominates a majority of its directors. During the period the dealer is under financing by the division, it maintains close supervision over the dealer's activities to insure successful operation. During 1957-1958, Motors Holding financed four dealers in the District. (R. 459-62.)

General Motors Acceptance Corporation (GMAC), whose function it is to provide to a dealer financing of new car purchases, financed during 1957 and 1958 all four of the Pontiac dealers in the District. Under this financing, GMAC secured title to all automobiles purchased by the dealers, title passing to GMAC at the factory. (R. 406-07.)

In addition to the regular operations of car division personnel, other officials of the several divisions made regular business visits to the District, and division zone personnel actively participate in an annual automobile show held in the District and supply display materials and automobiles for the show. The activities of the personnel of the several car divisions, in respect of assisting and advising dealers as well as the activities directly related to the public, are designed to promote sales and to attract retail customers to the dealers. The affect was, thus, to cause orders from the dealers for petitioner's products to flow to General Motors automatically without the necessity for specific solicitation. (R. 408-10.)

General Motors also maintained offices within the District for the following activities: its Government Sales Section (liaison activities related to government purchase of trucks and passenger car vehicles) (R. 433-35), Cleveland Diesel Engine Division (government liaison in connection with sales of defense materials) (R. 442-44), Detroit Diesel Engine Division (government liaison in connection with sales of defense materials) (R. 444-46), United Motors Service Division (sales at wholesale of parts and accessories) (R. 446-50), AC Spark Plug Division (military type manufactiung, manufacture of automotive parts, government liaison and contact) (R. 435-38), Motors Holding Division (financing dealers with voting control in General Motors) (R. 459-62), Business Research Staff (forecasting economic conditions and effect on sales) (R. 456-57), General Motors Overseas Division (dealing with United States and other governments and international

agencies in respect of products sold abroad) (R. 457-59), Patent Section (patent research and detailed work regarding litigation) (R. 462), and Public Relations Staff (lobbying, press and communications relations, services to General Motors visiting executives) (R. 462-64). In addition, General Motors Acceptance Corporation, a wholly-owned subsidiary, which financed dealers, had an office in the District. (R. 406-07.)

During the course of the trial before the Tax Court, petitioner produced four economists to state their views on the propriety, from an economic standpoint, of the application to General Motors of the District's apportionment formula. Each of these economists stated that the formula to be used should consist of the factors of capital investment (property) and labor (payroll) or costs. On the matter of the inclusion of sales as a factor in the formula, one of the economists stated unequivocally that he would allow only for the factors of property and payroll, without consideration to sales. Although not subscribing to a three-factor formula which would include sales as one of the factors (since in their view as economists income is produced only by capital and labor), petitioner's remaining witnesses were substantially in agreement that a three-factor formula which includes sales as one of the elements would not be particularly objectionable because sales, in some way or other, might reflect costs. Thus, there was disagreement among petitioner's own witnesses concerning a proper formula. (R. 68-69, 72-73, 99-100, 127, 151-54, 351-54, 356.)

Three expert economists testified for the District. Contrary to the testimony of petitioner's witnesses, the District's experts were in complete agreement that the District's apportionment formula is entirely reasonable and provides an appropriate formula for the purpose of apportioning General Motors' net income. These witness were further of the opinion that a two-factor formula consisting

of capital and labor, or a three-factor formula consisting of capital, labor, and sales, would not result in a more reasonable apportionment and, in fact, might well result in an improper apportionment of General Motors' income for tax purposes. (R. 208-10, 258-65, 295-99.)

In the year 1957, petitioner's sales to all of its customers amounted to $9,461,855,874, of which $37,185,704 derived from sales to District customers. The apportionable net income of petitioner amounted to $1,312,092,839. Applying the District's apportionment formula, the net income apportionable to the District for 1957 amounted to $5,156,525, less than four-tenths of one per cent of petitioner's total net income.

In 1958, petitioner's total sales to all of its customers were $7,853,393,381, of which $32,542,519 derived from sales to District customers. Apportionable net income for that year was $653,396,893 and the amount apportionable to the District, employing the District's formula, was $2,707,677, slightly more than four-tenths of one per cent of the net income subject to apportionment. (R. 465-69, 470e-470f, 477-81.)

The Tax Court declined to sustain the District's determination of General Motors' franchise tax liability for the years 1957 and 1958, holding that the District's formula, as applied to General Motors, was improper. That court devised a new and different formula consisting, not of the two factors of property and payroll, for which petitioner's economists had testified, but of three factors of property, payroll, and sales, equally weighted. (R. 487, 525-29.) On the basis of its formula, the Tax Court revised the District's assessments, ordering a refund to be made to General Motors of the difference. (R. 515-20.) The District appealed the decisions of the Tax Court to the United States Court of Appeals for the District of Columbia Circuit and a division of that court on February 21, 1968, affirmed the Tax Court, one judge dissenting. (R. 582-85, 592-96.)

Thereafter, on rehearing en banc, the entire court, four judges dissenting, reversed the Tax Court, holding that the District's apportionment formula is in all respects valid and applicable to General Motors Corporation. (R. 599-637.)

ARGUMENT

This case involves the District of Columbia Income and Franchise Tax Act of 1947, a statute applicable only in the District of Columbia and enacted by the Congress under its plenary power for the purpose of providing revenues requisite to the maintenance of essential District of Columbia functions. This Court has declined to review matters of a local nature confined in their application to the administration of District of Columbia law. *American Security and Trust Co.* v. *District of Columbia*, 224 U.S. 491 (1912); *United Security Co.* v. *American Fruit Product Co.*, 238 U.S. 140 (1915). As was said in *Del Vecchio* v. *Bowers*, 296 U.S. 280, 285 (1935):

> "In the view that the case does not fall within Rule 38, the respondent opposed the issuance of a writ of certiorari. The objection might be valid if the statute were confined in its operation to the District of Columbia. We will not ordinarily review decisions of the United States Court of Appeals, which are based upon statutes so limited or which declare the common law of the District."

The apportionment method employed by the District under regulations promulgated by the Commissioners of the District of Columbia pursuant to the Income and Franchise Tax Act of 1947 is not of recent origin, nor novel in its concept, for it has been in existence in substantially the same form since the inception of the act and was in use under the District of Columbia Income Tax Act of 1939,

the taxing act which preceded the present one, a total period of approximately twenty-seven years. This method utilizes a single factor of sales for the purpose of apportioning to the District income subject to District tax in cases where the taxpayer, as General Motors, is engaged in the business of selling personal property within and without the District. In cases arising under these Congressional taxing statutes the highest court of the District of Columbia has had frequent occasion to consider the validity of the District's apportionment formula and has sustained it. *Panitz* v. *District of Columbia*, 74 App.D.C. 284, 122 F.2d 61 (1941); *Eastman Kodak Co.* v. *District of Columbia*, 76 U.S.App.D.C. 339, 131 F.2d 347 (1942); *Lever Bros. Co.* v. *District of Columbia*, 92 U.S.App.D.C. 147, 204 F.2d 39 (1953); *District of Columbia* v. *Radio Corporation of America*, 98 U.S.App.D.C. 119, 232 F.2d 376, *cert. denied*, 352 U.S. 845 (1956); *Smoot Sand and Gravel Corp.* v. *District of Columbia*, 104 U.S.App.D.C. 292, 261 F.2d 758 (1958), *cert. denied*, 359 U.S. 968 (1959); *District of Columbia* v. *Evening Star Newspaper Co.*, 106 U.S.App.D.C. 360, 273 F.2d 95 (1959). All of these cases involved either an attack upon the validity of the Commissioners' regulatory apportionment formula, or the application of that formula to the factual circumstances present in the particular case in controversy. Attacks comparable to that made by General Motors have been made upon the formula on the ground that the formula is invalid for the reason that it failed to take into account the fact that personal property sold by the taxpayer in the District was produced by it elsewhere. These attacks were rejected by the Court of Appeals in *Eastman Kodak Co.* v. *District of Columbia, supra* and *Smoot Sand and Gravel Co.* v. *District of Columbia, supra.* Moreover, in *Smoot*, the taxpayer specifically urged that decisions of this Court require, and the Congress intended, that the District employ a three-factor apportionment formula based on sales, manufacturing costs, and property

values, the formula which General Motors urges must be applied to it.

In response to the argument of General Motors that the District must emply a three-factor formula using as ingredients sales, property, and payroll, each equally weighted, the majority of the Court of Appeals in this case said:

> "**** Read as we read it, the statute clearly permits although it does not require the single-factor sales formula adopted by the Commissioners.
>
> "The General Motors interpretation is obviously a complex and sophisticated one. We believe it more probable that the District's apportionment reflects the intent of Congress." R. 619.

Rejected also by the court were arguments of General Motors, reiterated in its petition for writ of certiorari, that the District's formula is violative of the Constitution. Every contention which General Motors argues here was argued fully before the Court of Appeals and fully answered by that court.

That the District's single-factor sales formula is not an improper formula for apportionment purposes is demonstrated by the fact that *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920); *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U.S. 271 (1924); and *National Leather Co.* v. *Massachusetts*, 277 U.S. 413 (1928), each sustained the use of a one-factor formula under the proof adduced in those cases.

General Motors argues that the District's formula violates the Commerce Clause of the Constitution, saying at page 11 of its petition:

> "The Commerce Clause prohibits the imposition upon interstate commerce of such cumulative burdens to which intrastate business is not subject."

It agrees, however, that the Commerce Clause is not a restraint upon the power of Congress to legislate for the District, but claims that it is a restraint upon action by the Commissioners of the District of Columbia. It relies upon *Stoutenburgh* v. *Hennick*, 129 U.S. 141, 148 (1889), referred to in *District of Columbia* v. *John R. Thompson Co.*, 346 U.S. 100, 107 (1953). But *Stoutenburgh* involved not a formula devised for the apportionment of income for District tax purposes under an act of Congress, but an act of the District's Legislative Assembly, which was in all respects comparable to an enactment of a state legislature. Contrary to the matter involved in *Stoutenburgh*, the District's tax act, by its terms, requires apportionment to the District of that portion of the taxpayer's net income which reasonably can be said to have resulted from District activities. A formula which achieves that result, as does the District's, is in no wise invalid simply because it may incidentally involve interstate activities. *Butler* v. *McColgan*, 315 U.S. 501 (1942). Moreover, the District's act specifically provides for apportionment of the income of taxpayers engaging in multi-state operations,[1] for it says in article I, title X, section 2, § 47-1580a, D.C. Code, 1961, that:

> "**** If the trade or business of any corporation or unincorporated business is carried on or engaged in both within and without the District, the net income derived therefrom shall, for the purposes of this article, be termed to be income from sources within and without the District."

General Motors' contention that the Commissioners' regulation under the statute is unconstitutional because General Motors "earned" its income through a series of transac-

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[1] Quoted at page 87a of General Motors' Petition. *Cf. Mercury Press, Inc.*, v. *District of Columbia*, 84 U.S.App.D.C. 203, 173 F.2d 636 (1948), *cert. denied*, 337 U.S. 931 (1949).

tions outside the District, as well as within it,[2] is answered by the fact that General Motors is engaged in a unitary business; the District is entitled to tax that portion of the income of the corporation which may be said to be fairly attributable to its activities within the District, just as was the case of New York State in *Bass, Ratcliff & Gretton* v. *Tax Commission,* 266 U.S. 271 (1924). In none of its decisions has this Court ever stated that an apportionment formula is invalid because it employs a single factor for apportionment of income; only where the method employed is grossly unreasonable has this Court, as in *Hans Rees' Sons, Inc.* v. *North Carolina,* 283 U.S. 123 (1931), invalidated a state's method of taxing multi-state income. That *Hans Rees' Sons,* so strongly relied upon by petitioner, is not applicable here is demonstrated by the statement of the Court of Appeals in its opinion that that case "*** does not closely resemble the one before us."[3]

General Motors argues, at pages 12 and 14 of its petition, that double taxation was established and also that a grossly disproportionate taxation was established. It bases its arguments almost entirely on statements of the Tax Court, whose conclusions were emphatically rejected by the Court of Appeals. In essence, the argument of General Motors is that because other states use formulas differing from that of the District, income taxed by the District would be taxed elsewhere. It attempts to demonstrate this result by hypothetical examples. But the examples appear to be self-defeating, for, in progression, it is possible to demonstrate that unless all formulas in use throughout the United States are identical and identically applied, each could be subject to attack on the ground of potential double taxation. This is a matter analogous to that envisioned by this Court in *Butler Bros., supra.,* where, after referring to

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[2] Petition p. 11
[3] R. 625.

the central purchasing method used by the taxpayer and its argument that this method, and not sales in California, produced profit, the Court quoted with approval the statement of the Supreme Court of California that:

> "Thus, by proceeding in turn from state to state, it could be shown that none of the sales in any of the states should be credited with the income resulting from the purchasing of goods in large quantitites." 315 U.S. at 509.

That General Motors' argument in this regard could lead to the questioning of the validity of any taxing formula can be demonstrated by the fact that the cases cited by petitioner at page 10 of its petition involved differing state taxing formulas which, necessarily, produced different tax results. Even in states employing the same kind of formula, the application of the formula would, in every case, have to be entirely consistent with the application of the formula elsewhere in order to avoid "double taxation." As an example, in the case of identical multi-factor formulas with payroll as one of the factors, it is entirely conceivable that one taxing jurisdiction could with justification include in that factor the pay of an employee which, for adequate reasons, is included in the payroll factor of another jurisdiction, thus providing an overlap which results in the taxing by both jurisdictions of a similar segment of income. Preciseness, as this Court has said many times, and as petitioner recognizes, is not required and perhaps not obtainable. (See Petition p. 15.)

Arguing that the District's formula improperly apportioned to the Distrtict a part of General Motors' net income which was greater than that which the District was allowed to tax, General Motors says:

> "In contrast, the single-factor *sales* formula reaches and is designed to reach the *entire* net in-

> come connected with every sale into the District, including profits earned by the application of capital and services in other jurisdictions." Petition p. 18 (petitioner's italics).

By statute the Commissioners' formula is required to provide to the District for tax purposes that amount of net income, so far as can be reasonably determined, which General Motors obtained through its District activities. As the District's statute provides:

> "**** The measure of the franchise tax shall be that portion of the net income of the corporation and uncorporated business as is fairly attributable to any trade or business carried on or engaged in within the District and such other net income as is derived from sources within the District." § 47-1580, D. C. Code, 1961.

Significantly, petitioner speaks in terms of profits earned by the application of capital and services in other jurisdictions, not income from sales.[4] But nowhere has General Motors demonstrated that the District's formula, in fact, attributed to the District more of the corporation's net income than was reasonably attributable to its activities in the District. Moreover, the facts show that General Motors' activities in the District are extensive and varied, involving much more than the sale of its products. If, as contended by General Motors, income derived by it from activities outside the District may, in some unstated degree, be affected by the District's formula, similarly, much of the income of General Motors from activities outside the District may be produced by its activities within the District, for it maintains many offices here for the purpose of the sale of its products to the United States and for other purposes—all of which are directly connected with the generat-

[4] Petition p. 18.

ing of income. Accepting General Motors' premise, it is entirely conceivable that instead of apportioning too great an amount of the corporation's net income to the District, the Distrtict apportioned too little.

Relying on the Tax Court,[5] General Motors attacks the Court of Appeals' conclusion that the District's apportionment formula is not contrary to the taxing statute. Basically, the contentions of petitioner are stated in the form of hypothetical examples in no way pertinent to the situation existing in respect of General Motors. By hypothetical extremes completely inapplicable to it, General Motors attempts to show that it was unfairly taxed. Yet, as the record demonstrates, witnesses for General Motors contended before the Tax Court that only a formula consisting of factors of capital and labor or costs would fairly apportion its income.[6] Based on its own witnesses, General Motors (in any case where all of its payroll and property, for all practical purposes, are located in one jurisdiction and its sales are made in another), would not attribute to the jurisdiction of sale any of its income except in *de minimus* amounts. This is an equally extreme result.

The short answer to the examples employed by General Motors to buttress its contention that the District's regulatory formula is contrary to the statute is that the Court of Appeals has held it valid and that General Motors has not demonstrated that under this formula it has been improperly or unfairly taxed.

The operations of General Motors in the District of Columbia are much more varied and extensive than those which this Court described in its opinion of June 8, 1964, in *General Motors Corporation* v. *Washington*, 377 U. S. 436. General Motors maintains many more offices, and conducts many more activities in the District than it did in the State of Washington. Although in the conduct of

[5] Petition pp. 19-23.
[6] R. 99, 126-27, 137, 151-54.

certain of its activities, General Motors maintained in Washington some offices which it does not have in the District, all of the types of activities conducted by General Motors in that state are conducted in the District. Moreover, General Motors concedes its liability to District franchise tax, arguing only that the tax *must* be determined upon the basis of the formula devised by the District of Columbia Tax Court, and rejected by the Court of Appeals.

In *General Motors Corporation* v. *Washington*, the tax was imposed against General Motors for the privilege of engaging in business activities within that state, measured by General Motors' gross wholesale sales of motor vehicles, parts, and accessories delivered in that state. Despite contentions by General Motors that the tax was an unapportioned gross receipts tax on sales which constituted an inherently discriminatory tax on the privilege of engaging in interstate commerce, that it resulted in multiple tax burdens, and that it deprived General Motors of its property without due process of law (contentions substantially identical to those it makes in respect of the District's tax), both the Supreme Court of Washington and this Court held that Washington's tax was valid. Washington's tax was unapportioned and was directed to gross receipts; the District's tax is an apportioned tax, based not upon gross receipts, but upon General Motors' *net* income.

The considerations which in *Washington* this Court stated required it to reject General Motors' arguments against the validity of Washington's taxing act are at least equally applicable when applied to the District of Columbia.

CONCLUSION

For the foregoing reasons and in light of Rule 19 (1) (b) of this Court, it is apparent that petitioner has not shown that the decision below is in any way in conflict with decisions of another Court of Appeals or with applicable deci-

sions of this Court. Furthermore, the Court of Appeals for the District of Columbia Circuit, sitting en banc, clearly did not decide "an important state or territorial question in a way in conflict with applicable state or territorial law" since that court itself, as the highest judicial authority of the District, expounds the law for the District. Accepting *arguendo,* petitioner's contention that there are important questions of federal law involved in the instant case, those questions have already been determined by this Court against petitioner in numerous cases including *General Motors Corporation* v. *Washington, supra.*

Respondent respectfully submits that this case, involving matters of essentially local concern to the District of Columbia, does not warrant the exercise of this Court's sound judicial discretion to review the decision below on a writ of certiorari, and the petition should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. 352

GENERAL MOTORS CORPORATION, *Petitioner*,

v.

DISTRICT OF COLUMBIA, *Respondent*.

Objection to Motions by Associated Industries of New York State, Inc., and Bethlehem Steel Company for Leave to File Briefs Amici Curiae in Support of the Petition for Writ of Certiorari

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Pursuant to Rule 42 (3) of the Rules of the Supreme Court of the United States, Respondent District of Columbia respectfully opposes the motions by Associated Industries of New York State, Inc., and Bethlehem Steel Company for leave each to file a brief *amicus curiae* in support of the petition for writ of certiorari in the above-entiled case. Respondent has withheld its consent to the filing of said briefs for the reasons set forth below.

Rule 42 (3) of the Court requires an applicant for *amicus curiae* to

> "*** state the nature of the applicant's interest, set forth facts or questions of law that have not been, or reasons for believing that they will not adequately be, presented by the parties, and their relevancy to the disposition of the case***."

It is respectfully submitted that neither applicant herein has fulfilled these requirements, nor can either applicant do so. Primarily, neither applicant has set forth any facts or questions of law that have not been adequately presented by the petitioner or by the respondent herein. Applicant Associated Industries of New York State, Inc., states merely that it wishes "to clarify the presentation" and Applicant Bethlehem Steel Company "to emphasize to the Court the importance" of the questions already presented and emphasized by the petitioner.

Both parties in this case are, and have been through some three years of litigation, adequately represented by competent counsel, and all issues have been fully presented throughout. That the applicants have presented no issues of fact or law not already fully presented by the parties herein is manifest from the fact that the "Questions Presented" of the proposed brief of Applicant Associated Industries of New York State, Inc., are essentially identical to the "Questions Presented" by the petitioner herein. The proposed brief of Applicant Bethlehem Steel Company, while not setting forth any formal "Questions Presented," similarly propounds, at pp. 5-6, the very same issues which the applicant for the writ of certiorari desires to be decided by this Court. What was said by this Court in 1903 is precisely applicable to the present case: "as the parties are represented by competent counsel, the need of assistance cannot be assumed ***." *Northern Securities Co.* v. *United States*, 191 U.S. 555, 556 (1903). See also *United States* v. *General Electric Co.*, 95 F. Supp. 165 (D.N.J. 1950).

The function of an *amicus curiae* is to call the Court's attention to matters of law which might otherwise escape

its consideration or cause it to make error. See generally 4 Am. Jur. 2d, *Amicus Curiae;* 3 C.J.S., *Amicus Curiae.* An *amicus curiae* is technically a "friend of the Court," as distinguished from an advocate. *Allen* v. *County School Board of Prince Edward County,* 28 F.R.D. 358 (E.D. Va. 1961). See also *United States* v. *Loew's, Inc.,* 20 F.R.D. 423 (S.D. N.Y. 1957), wherein it was held that the proposed intervenor's current position as an adverse party litigant in a private antitrust action in another federal District Court, would impair its effectiveness as *amicus curiae* and leave to act as such was denied. By reason of the stated interests of the applicants in the instant case and in its outcome, neither is in a position to give this Court the disinterested and nonpartisan advice which is in the highest tradition of *amici curiae.*

Applicant Associated Industries of New York State, Inc., asserts in its motion, p. 2, that, because of the decision in this case by the United States Court of Appeals for the District of Columbia Circuit, sales by its members in the District of Columbia "for the years in question, 1957 and 1958," "are now taxable by the District of Columbia on 100% of the net income." However, in respect of District income and franchise taxes, section 47-1586i (a) (1), D. C. Code, 1961, states that:

> "(1) the amount of income taxes imposed by this subchapter shall be assessed within three years after the return is filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period ***."

The applicant does not state, and respondent is not advised, whether any of its members have matters pending before the District tax authorities. The applicant similarly does not state any reasons why the above-quoted limitation might

not apply,[1] nor is there any question that more than three years have elapsed since the years concerned. Based on the bare assertion set forth above. the applicant thus expresses apprehension concerning the imposition of a tax which cannot, under the applicable act of Congress, be assessed or collected. Its stated interest in the instant case is therefore remote and hypothetical. The words of *Northern Securities Co., supra,* are again appropriate: "It does not appear that applicant is interested in any other case which will be affected by the decision of this case***." The application should therefore be denied.

Applicant Associated Industries of New York State, Inc., further states that the decision by the Court of Appeals below "constitutes an open invitation to other jurisdictions to enact similar one-factor formulae, thus subsidizing intrastate business by burdening interstate commerce with discriminatory and multiple taxation." Assuming, but not conceding, that this assertion constitutes a statement of relevancy to the disposition of this case of questions not adequately presented by the parties, the point is not well taken. The Congress of the United States exercises full plenary power over the District of Columbia. *Neild* v. *District of Columbia,* 71 U.S.App. D. C. 306, 110 F.2d 246 (1940), *approved, National Mutual Insurance Co.* v. *Tidewater Transfer Co., Inc.,* 337 U.S. 582, 601-02 (1949). Legislation for the District is not therefore circumscribed by the commerce clause. In fact, Congress may "discriminate" in tax legislation for the District of Columbia when states may not constitutionally enact similar discriminatory taxation measures. *Mercury Press, Inc.* v. *District of Colum-*

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[1] See D.C. Code, 1961, § 47-1586i (a) (3) (five year statute of limitations for omission from gross income of an amount in excess of 25 per cent of the amount of gross income stated in the taxpayer's return; five years, however, would have already elapsed since the years in question, 1957 and 1958), and § 47-1586i (b) (no limitations for a false or fraudulent return).

bia, 84 U.S.App.D.C. 203, 173 F.2d 636 (1948), *cert. denied*, 337 U. S. 931 (1949). The decision of the court below with respect to the unique tax authority of the District of Columbia thus by no means "constitutes an open invitation to other jurisdictions" to promulgate similar tax measures. The applicant therefore fails to establish that the taxation of its members in other jurisdictions is relevant to the disposition of this case. For the same reasons the applicant fails to state an interest in the instant case arising from any supposed harm to the commerce of its member companies in other jurisdictions.

Applicant Bethlehem Steel Company does state an interest in the form of appeals, claims for refund, and protests pending before the District of Columbia tax authorities. However, as above stated, it has altogether failed to set forth any "facts or questions of law that have not been, or reasons for believing that they will not adequately be, presented by the parties."

For the foregoing reasons, and for the additional reason that motions for leave to file briefs *amici curiae*, consent having been refused, "are not favored" (Rule 42 (1)), it is respectfully submitted that the motions by Associated Industries of New York State, Inc., and Bethlehem Steel Company for leave to file briefs *amici curiae* in support of the petition for writ of ceriorari should be denied.

Respondent has received additional requests to consent to the filing of briefs *amici curiae* in support of the petition for certiorari in this case. Consent to those requests has similarly been withheld. Respondent has no information as to whether other motions such as those opposed herein will be filed. However, insofar as the reasons stated herein may be applicable to any further motions for leave to file

briefs *amici curiae*, respondent respectfully opposes such motions on the same grounds as above stated.

Respectfully submitted,

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IN THE

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OCTOBER TERM, 1964

No. 352

GENERAL MOTORS CORPORATION, *Petitioner*,

v.

DISTRICT OF COLUMBIA, *Respondent*.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF AMICUS CURIAE OF THE NATIONAL ASSOCIATION OF MANUFACTURERS OF THE UNITED STATES OF AMERICA IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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GENERAL MOTORS CORPORATION, *Petitioner*,

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DISTRICT OF COLUMBIA, *Respondent*.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

MOTION OF THE NATIONAL ASSOCIATION OF MANUFACTURERS OF THE UNITED STATES OF AMERICA FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

Pursuant to Rule 42 of the Rules of this Court, the National Association of Manufacturers of the United States of America respectfully moves this Court for leave to file the accompanying brief in support of the petition by General Motors Corporation for a writ of certiorari in the above-entitled case.

The National Association of Manufacturers is a nonprofit voluntary business organization organized as a membership corporation under the laws of the State of New York. It is composed of more than 15,000 manufacturing concerns, including corporations, partnerships, sole proprietorships, and other forms of business enterprises, located throughout the United States and its territories. These concerns range from the very small to the very large and represent about 75 percent

of the industrial employment in the United States. Most of these concerns engage in interstate commerce to some degree, and are therefore subject to various types of state corporation taxes, including franchise taxes.

Counsel for Petitioner, General Motors Corporation, has granted consent to the filing of such brief *amicus curiae*. The Respondent, through its attorney of record, has declined consent.

The Association has an interest in this case by reason of the substantial effect, both immediate and potential, that the decision of the Court of Appeals for the District of Columbia Circuit will have upon the Association's members. The Association seeks to emphasize the far-reaching effect of this decision, to point out certain aspects of previously-decided cases that have not been presented in General Motors' petition, and to demonstrate that the Court of Appeals is setting a standard of proof that is impossible of fulfillment in this and future cases.

We, therefore, urge that leave be granted to file said brief and respectfully so move the Court.

Respectfully submitted,

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IN THE

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DISTRICT OF COLUMBIA, *Respondent*.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS OF THE UNITED STATES OF AMERICA IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

The National Association of Manufacturers of the United States of America, with leave of this Court, respectfully presents this brief in support of the Petition for a Writ of Certiorari.

INTEREST OF AMICUS CURIAE

The interest of the National Association of Manufacturers is set forth in the accompanying Motion for Leave to File Brief Amicus Curiae.

ARGUMENT

The Court of Appeals based its decision in this case principally upon its interpretation of three cases decided by this Court: *Underwood Typewriter Co.* v. *Chamberlain,* 254 U.S. 113 (1920); *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450 (1959); and *Hans Rees' Sons, Inc.* v. *North Carolina ex rel. Maxwell,* 283 U.S. 123 (1931). We believe that the Court of Appeals ignored vital aspects of each of these cases.

The Court relied on the *Underwood* case for the proposition that even in a unitary business and under a single-factor formula, the taxpayer must prove arbitrary and unreasonable taxation by precise percentage apportionments. But the lack of evidence in *Underwood* was wholly dissimilar to the alleged lack of evidence here.

In *Underwood* the taxpayer's tangible property in Connecticut was 47 percent of its total tangible property, and Connecticut taxed 47 percent of net profits derived from tangible property. The taxpayer's argument was that it had gross receipts of $1.5 million from rentals, repairs, commissions, etc., on property located outside of Connecticut but manufactured in Connecticut, and that there was no logical connection between its manufacturing facilities in Connecticut and these receipts. (*Underwood Typewriter Co.* v. *Chamberlain,* Brief and Argument on Behalf of the Plaintiff In Error, pp. 16, 32-33; Transcript of Record, pp. 23-

25.) The taxpayer went further: it argued that profits as such from sales of new machines sold outside Connecticut could only be taxed where sold.[1] It argued at length against the application of any "unity rule" of taxation to a manufacturing company (Brief and Argument, *supra*, pp. 42-61), pointing out that its "factory force do not meet the customers at all; and it is of no consequence where the factory is located" (*id.* at 45). The only facts before the trial and appellate courts were those stipulated by both parties, and in these there was no attempt whatever to show double taxation (Brief and Argument of Defendant in Error, pp. 9-22; Transcript of Record, pp. 23-35).

This Court rejected the taxpayer's theory in *Underwood* that there was no connection between manufacture and subsequent transactions involving the manufactured products. Rather, said the Court, profits were directly related to a series of events, beginning with and including manufacture, and *nothing* in the record showed that 47 percent of net income was not attributable to the state of manufacture (*Underwood Typewriter Co.* v. *Chamberlain, supra*, 254 U.S. at 120-121).

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[1] *E.g.*, "[W]ith respect to sales of new machines manufactured in Connecticut, but sold outside of Connecticut, it is equally apparent that the income earned from such sales received in possession outside of Connecticut and which never reaches the borders of that State, is also properly located without the State. • • • The minute one applies the commercial agencies of selling to the finished product, the resultant profit is attributable only to the processes of sale. • • • Tangibles located without the State of Connecticut cannot possibly have any bearing upon the cost of manufacturing in Connecticut, nor do they in any way have any relation to the value of the finished products in Connecticut." Brief and Argument, *supra*, pp. 33-34, 36, 37.

In the instant case, on the other hand, the single-factor formula is based on sales, not property; it reaches the entire income from every District of Columbia sale, and there are both evidence and findings to the effect that such income is attributable in part to other states and is in fact taxed by other states.

The Court of Appeals relied upon language in *Northwestern States Portland Cement Co.* v. *Minnesota, supra*, 358 U.S. at 462-463, to the effect that the taxpayer must demonstrate burdens on interstate commerce rather than force the Court to deal in abstractions.[2] But the record in *Northwestern States* not only distinguishes that case from this one but helps to demonstrate the difference between an "abstraction," or impermissible hypothetical, and the valid example of double taxation set forth by General Motors.

In the *Northwestern States* companion cases, the taxpayers' real objection was not that the states' three-factor formulae were unfair but rather that the taxpayers had insufficient connections with the states to allow them to be taxed on their purely interstate business.[3] During the course of its argument, however, Northwestern States did say that "The statute in-

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[2] Appendix to General Motors' Petition, pp. 74a-75a. See also the Court of Appeals' reliance on *Northwestern States* at pp. 59a n. 12, 67a n. 26, and 72a.

[3] For example, in the companion case of *Williams* v. *Stockham Valves and Fittings, Inc.*, decided in the *Northwestern States* opinion, the Supreme Court of Georgia stated: "No question is raised by the plaintiff as to the reasonableness of the apportionment of its net income to Georgia under the prescribed statutory apportionment formula or to the amount of taxes, if liable; but the plaintiff contends that the state is without jurisdiction to impose a net income tax upon a foreign corporation engaged within Georgia in exclusively interstate commerce" (Transcript of Record, p. 30).

volved here is so designed that it *could easily lead* to multiple taxation of interstate commerce, a burden not imposed upon purely local or intrastate commerce" (*Northwestern States Portland Cement Co.* v. *Minnesota*, Brief for the Appellant, p. 13; emphasis added). To support this assertion, Northwestern States asked the Court to assume that instead of being an Iowa corporation doing business in Minnesota, it was a Minnesota corporation doing business in Iowa. It then applied the three-factor formula to its assets, concluded that 99.424 percent of its income would be taxed by Minnesota, and reasoned that "This state of facts clearly demonstrates that a net income tax can be a real burden on interstate commerce" (*id.* at 29; emphasis added).

As pointed out by Minnesota in its reply, however, Northwestern States in this hypothetical not only transposed the facts but incorrectly assigned 100 percent of its sales to Minnesota. Actually, Minnesota, unlike the District of Columbia, allocated sales *to the state in which the office of the origin of the sale was located.* Applying the correct formula, said the State, "would result in a much smaller portion of the total net income assignable to Minnesota than the appellant asserts, and when added to the portions attributable to other states having fair apportionment formulae would result in taxing no more than 100% of the appellant's income" (*id.*, Brief for the Respondent (sic), pp. 39-41).

It was this type of hypothetical abstraction by Northwestern States—removed from the facts of the case and based on questionable assumptions—to which this Court addressed itself in its *Northwestern States* opinion. The hypothetical set forth by General Mo-

tors, on the other hand, illustrates the precise situation confronting the company. It was by proof, and not by an abstraction, that it showed its income being taxed not only by the District but by Delaware, Maryland and Michigan, as the Tax Court found (Appendix to General Motors' Petition, Finding 3, pp. 2a-3a). General Motors does not argue that the District's single-factor formula "could easily lead" to illegal taxation under some other set of facts, but rather that the formula *has led* to multiple taxation and undue burdens on commerce under the specific facts of this case, just as the Tax Court found (Appendix to General Motors' Petition, Findings 3, 5, 6, pp. 2a-4a).

The Court of Appeals distinguished *Hans Rees' Sons, Inc.* v. *North Carolina ex rel. Maxwell*, *supra*, 283 U.S. 123, on the ground that there the taxpayer's North Carolina operations "accounted for an identified percentage" of its total net income, and that this evidence was "specific," "tangible," and "concrete" (Appendix to General Motors' Petition, pp. 69a-71a). General Motors, said the Court of Appeals, failed to supply such evidence here.

But the evidence in *Hans Rees' Sons* was never adequately tested by the State, because a ruling by the trial judge made it unnecessary to do so. The evidence consisted of a series of computations based in turn on certain assumptions that may or may not have been permissible (*Hans Rees' Sons, Inc.* v. *North Carolina*, Brief and Argument for Appellant, pp. 18-32). All of this evidence was stricken from the record by the trial judge, who viewed it as immaterial. The North Carolina Supreme Court did not pass on the evidence either, because it too viewed it as immaterial. The Court stated that while the evidence "tends to show" that

the average income having its source in the manufacturing and tanning operations within the State of North Carolina was 17 per cent, the trial judge was correct in striking the evidence because "the tax was computed in accordance with a statutory method which has been approved by the Court of supreme authority," and furthermore, even if the evidence was competent, the taxpayer was "conducting a unitary business" and "it is not permissible to chop off certain elements of the business constituting a single unit, in order to place the income beyond the taxing jurisdiction of this state" (*id.*, Record, pp. 164, 165, 166).

In other words, the North Carolina Supreme Court viewed the single-factor formula as having been approved by this Court in prior cases, regardless of the actual burden imposed by the formula, and also took this Court's language about a "unitary business" to mean that the business could not be broken down by the taxpayer for the purpose of allocating income. Even in this Court, the State did not contest the evidence so much as it relied on the legality of the formula, regardless of its impact.[4]

We stress this point because it is not at all clear that Hans Rees' Sons could have sustained its computations in the face of a full-fledged attack by the State, and it certainly is not clear that henceforth even taxpayers in the position of Hans Rees' Sons can support their allocations of income by similar computations. In any event, General Motors was not in the

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[4] *E.g.*, *Hans Rees' Sons, Inc.* v. *North Carolina*, Brief of Appellee, p. 19: "In other words, the act having been administered in good faith, the inequalities, if any, complained of by the appellant, were only these which resulted from the operation of a general, though valid, law."

position of Hans Rees' Sons, with separable buying profit, manufacturing profit, and selling profit, and with a single fungible product. Such computations when applied to General Motors' business or any other unitary business would be meaningless, as well as impermissible under *Butler Bros.* v. *McColgan,* 315 U.S. 501, 506-509 (1942).

We cannot emphasize too strongly that the practical effect of the Court of Appeals decision will be to prevent every unitary business of any complexity from proving unconstitutional taxation even where it is obvious that multiple taxation and undue burdens on commerce must result. The Court of Appeals decision will force economic experts to do what they assert they cannot legitimately do: allocate into precise percentages the income of a complex, unitary business that sells in interstate commerce. The decision will place a premium on meaningless or even false computations in an already overly-complex area of the law. We submit that there is no need for such precision when the facts and findings are comparable to those in the instant case.

There is a further point that we believe the Court of Appeals has overlooked in regard to the standard of proof required in apportioning income. In *Hans Rees' Sons,* this Court stated the applicable rule to be that "when the State has adopted a method *not intrinsically arbitrary,* it will be sustained until proof is offered of an unreasonable and arbitrary application in particular cases" (283 U.S. at 133; emphasis added), and "evidence may always be received which tends to show that a State has applied a method which, *albeit fair on its face,* operates so as to reach profits which are in no just sense attributable to transactions within

its jurisdiction" (*id.* at 134; emphasis added).[5] We submit that the present case involves a formula which is "intrinsically arbitrary," and which is not "fair on its face". Certainly this is true where, as here, there is the added factor of multiple taxation. The single-factor formulae involved in *Underwood* and *Hans Rees' Sons,* being based on the location of one of the principal factors of production (property), at least had a tendency to allocate income to its source, since the other factors of production would tend to be located where the property was employed. It was necessary, therefore, to demonstrate by proof that such was not the case. Here, on the other hand, the effect of the single-factor formula based on *sales* was to reach the entire net income connected with every sale to a District of Columbia customer, without regard to the location of the factors of production. Only by chance could such a formula ever produce an apportionment approximating a fair distribution of income between the District and the states in which manufacturing and other income-producing activities are carried on. When a formula is of that nature, it should not be necessary to show by "specific percentages" the degree to which the result deviates from a fair apportionment. To hold otherwise would nullify the constitutional protection, for if the type of showing made by General Motors is not valid, an entire group of companies is automatically barred from proving illegality.

There is a final point which we would stress to the Court. The Association feels very strongly that with the states constantly seeking new sources of revenue from corporations, the Court of Appeals decision may

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[5] See also the Court's two references to an "inherently arbitrary" method of allocation by the State (*id.* at 130, 131).

well signal a shift throughout the country in methods of income allocation. While this assertion is not capable of direct proof, our review of the history of state tax legislation leads us inevitably to this conclusion. The various three-factor formulae previously adopted by the states have been the result not of charity but of the states' conclusion that only by such apportionments can they avoid holdings of unconstitutionality. That is, only by allowing each state its proper due can each state hope to collect at all. But if the states are now told in effect that a single-factor sales formula is both permissible on its face and immune from attacks by any but the most simple business operations, there is little doubt that many states will take advantage of the implied invitation. The result will be extensive burdens on interstate commerce and multiple taxation of the most grievous kind. We therefore respectfully urge the Court to hear and decide the serious questions presented here at this most opportune time.

Respectfully submitted,

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October, 1964

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IN THE

Supreme Court of the United States

OCTOBER TERM 1964

No. 352

GENERAL MOTORS CORPORATION,
Petitioner,
v.
DISTRICT OF COLUMBIA,
Respondent

MOTION OF AUTOMOBILE MANUFACTURERS ASSOCIATION, INC., FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE
and
BRIEF OF AUTOMOBILE MANUFACTURERS ASSOCIATION, INC., AS AMICUS CURIAE

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MOTION OF AUTOMOBILE MANUFACTURERS ASSOCIATION, INC., FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

Automobile Manufacturers Association, Inc., respectfully moves this court for leave to file the accompanying brief in this case as *amicus curiae*. The consent of the attorney for the petitioner herein has been obtained, but the attorney for the respondent herein refused to consent to the filing of a brief by Automobile Manufacturers Association, Inc., as *amicus curiae*.

The applicant, Automobile Manufacturers Association, Inc., a non-profit trade association whose members manufacture and sell automotive vehicles in the United States, has an interest in this case in that several of its members have been assessed the franchise tax of the District of

Columbia. The assessed tax on these members is not being paid pending a final decision of the instant case, because their liability depends on a determination of the questions which are presented for decision in the instant case.

Automobile Manufacturers Association, Inc., believes that petitioner herein will be unable to give a full presentation of facts in the instant case. Automobile Manufacturers Association, Inc., is in possession of factual information relating to the impact of the challenged tax on the automobile industry. This information cannot be presented by petitioner, and it will be unknown to the Court unless presented by Automobile Manufacturers Association, Inc., as *amicus curiae*. It is desirable that the Court have these facts before them in considering the Petition for Writ of Certiorari filed herein by petitioner, because these facts demonstrate in part the scope of the issues and their importance both in the District of Columbia and nationally.

Respectfully submitted,

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BRIEF OF AUTOMOBILE MANUFACTURERS ASSOCIATION, INC., AS AMICUS CURIAE

THE ISSUE

The issue in this case is whether the District of Columbia has applied its franchise tax in a manner which violates the Commerce Clause (Art. 1, §8, cl. 3) and the Due Process Clause (Amend. V) of the United States Constitution. The District of Columbia Tax Court held that the tax was applied in an unconstitutional manner. The Court of Appeals for the District of Columbia Circuit reversed that decision. The *amicus curiae* believes that the Court of Appeals did not give proper consideration to the unfair manner in which the District apportions its tax and the actual double taxation which results from such apportionment.

INTEREST OF AMICUS CURIAE

Automobile Manufacturers Association, Inc., is a non-profit membership corporation organized under the laws of New York. The Association is composed of twelve members, who are the manufacturers of well over 90% of all passenger automobiles, trucks, and busses produced in the United States. The members are:

> American Motors Corporation, Checker Motors Corporation, Chrysler Corporation, Duplex Division of Warner Swasey Company, Ford Motor Company, General Motors Corporation, International Harvester Company, Kaiser Jeep Corporation, Mack Trucks, Inc., Studebaker Corporation, Walter Motor Truck Company, The White Motor Company.

All these members engage in interstate commerce. The goods of many members are shipped through interstate commerce into the District of Columbia. The members who ship goods into the District are faced with the same problem which General Motors has faced. They have been, or expect to be, assessed with the District of Columbia franchise tax. While they are willing to pay any tax which is measured by the activities fairly attributable to them within the District of Columbia, the present tax as interpreted by the District and by the majority of the Court of Appeals does not use such a measure.

General Motors argues that a three factor formula of apportionment would be fair in its case. It points out that a three factor formula is used in a number of states. The Court of Appeals held that a single factor formula, which was used by the District of Columbia in this case, is suffi-

cient. This Court by considering this case can instruct all taxing units that this single factor method of apportionment is unconstitutional. This will be an aid to all members of the *amicus*, whether or not they sell to District customers.

IMPORTANCE OF THE DECISION IN THIS CASE

The decision in this case should establish for taxing authorities the manner in which they may apportion their taxes. For states in which tax statutes do not provide for apportionment, it is necessary to apprise the state legislatures of the need for amendment to make their statutes constitutional. Because of the importance of interstate commerce in the economy of the country, the decision in this case should be made by the Supreme Court.

A second reason this *amicus* urges the Court to grant a petition for certiorari is that a number of its members will be directly affected by the final decision in this case, since they have been assessed the tax in the District of Columbia. They have not paid that tax because they, along with General Motors, have felt that the apportionment formula employed by the District is not fair.

The annual sales of members of the *amicus* have been in excess of $120,000,000 to customers within the District of Columbia. On the basis of the apportionment formula challenged in this suit, 100% of those sales are taxable in the District. Yet no member manufactures within the District. Only a few have offices or employees within the District. In some cases these members pay taxes measured by the same sales in other jurisdictions. Because of these facts the affected members believe that they should not be

taxed on a basis assigning 100% of their activities to the District of Columbia. Because of the minimal contacts of some members with the District, these members question whether the District has the power to tax them at all.

All persons engaged in interstate commerce are concerned with the threat that many states and local taxing units will adopt unfair apportionment formulas. The automotive industry is, of course, primarily interstate in character. Thus the annual gross receipts of the members of the *amicus curiae*, now in excess of $23,000,000,000, are to a large part subject to taxes in more than one state. If these states do not apportion their taxes fairly, then an undue burden will be placed upon the interstate commerce engaged in by these members.

ARGUMENT

While many of the complexities of today's society date from the Industrial Revolution in the nineteenth century, our complex political structure dates from the founding of the country. Because of the numerous and competing units of government which then existed, the framers of the Constitution took some pains to ensure that the varying claims of these units would not create chaos. One result of their efforts was the commerce clause.

The colonies had been commercial as well as agricultural states. Trading among themselves as well as with foreign countries was essential to the growth of the country. Therefore, the commerce clause was designed to protect this inter-state trade. It was against the interests of national development for one state to protect its own commerce by laying levies on goods arriving from other states. Likewise

it was wrong for a state to raise revenue by taxing the interstate commerce and not taxing commerce carried on within its borders.

On the other hand, this could not mean that interstate commerce should pay no taxes, leaving the burden of revenue entirely on sources within a state. Thus this Court has held that interstate commerce must pay its own way; it must return to a state payment fairly attributable to the services provided to it by that state. However, this has raised the difficult question of determining how much of the commerce is fairly attributable to one state.

Some states have sought to solve the problem by using formulas. By using such factors as capital, labor, and sales, an effort is made to apportion accurately and fairly to one state that part of the interstate business which occurred in that state. Other states and taxing units, however, use apportionment formulas which only seem to be fair. The District of Columbia is one such taxing unit.

A great deal of latitude must be left to local units on choosing the appropriate apportionment formula. However, there must also be limitations to prevent undue burdens on interstate commerce. The District of Columbia is primarily a consumer market. Therefore it is obvious that the greatest revenue will be achieved at the expense of interstate commerce if the only factor in the apportionment formula is sales. Since most capital and labor lie outside the District, nothing can be gained by including them in the formula.

This method of "fair" apportionment would be simple for other states to follow. States where manufacturing is done would consider only labor in their formula with perhaps some weight to property and none at all to sales. In those states where property is concentrated, that factor

would be weighted heavily. In this manner each state could tax interstate commerce to the hilt. Goods manufactured in one state, taxed on a formula giving 100% weight to labor, could be sold in another state where they are taxed on a formula giving 100% weight to sales.

Of course, the prime evil of this double taxation is that the local business which is carried on in intrastate commerce will only have to pay one tax. In this manner the protectionist policy of the states, and the desire to raise revenue at the least expense to their citizenry, returns. The danger sought to be corrected by the commerce clause once more threatens the growth of the country.

In such a situation it is proper for the Supreme Court to consider this case which presents a single factor apportionment formula. The case also contains proof that this formula imposed double taxation on General Motors. Thus the inequities of the case as well as the general need for guidance call for a decision from this Court. It is for these reasons that this *amicus curiae* urges the Court to grant a writ of certiorari in this case.

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MOTION FOR LEAVE TO FILE BRIEF AND BRIEF AMICUS CURIAE OF THE ELECTRONIC INDUSTRIES ASSOCIATION IN SUPPORT OF THE PETITION FOR WRIT OF CERTIORARI.

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MOTION FOR LEAVE TO FILE BRIEF AND BRIEF AMICUS CURIAE OF THE ELECTRONIC INDUSTRIES ASSOCIATION IN SUPPORT OF THE PETITION FOR WRIT OF CERTIORARI

Pursuant to Rule 42 of the Supreme Court of the United States, Electronic Industries Association respectfully moves this Court for leave to file the accompanying brief in support of the petition by General Motors Corporation for a writ of *certiorari* in the instant case. Counsel for petitioner has stated that petitioner consents to the filing of this brief, but counsel for the respondent has refused.

The Electronic Industries Association (hereinafter referred to as EIA) has approximately 325 member

companies. These companies manufacture electronic devices and market them throughout the United States. EIA is national in scope, and represents the fifth largest manufacturing industry in the United States, with gross annual sales exceeding $15 billion.

Some of the larger members of EIA have their own distribution outlets, either as divisions or subsidiaries. However, the majority of the members of the Association are electronic companies whose sales total $25 million or less annually. The smaller members rely on sales to established distributors or dealers, or sales through manufacturers representatives, as their method of distributing their products. Sales to dealers and distributors are solicited by salesmen traveling through many states.

In addition, it is essential that electronic manufacturers provide engineering advice and service to the ultimate users of their products. Without this technical assistance the user would find difficulty in suiting the application of the various devices to his specific needs.

The activities of the salesmen, engineers, servicemen, and manufacturers representatives, being spread over many states, are likely to and do expose Association members to net income taxes in many states, and the District of Columbia. Because of this exposure, fair apportionment of net income for tax purposes is a subject of concern to EIA and its members. If the decision of the majority of the Court of Appeals is permitted to stand, the existing situation in which the District is permitted to tax 100% of the net income of sales to its residents, though a considerable percentage of such income has been earned and taxed

elsewhere, will persist, to the detriment of the commerce of the Association's members with customers in the District. Moreover, if the states are free to adopt as a standard of fairness the rationale of the decision of the Court of Appeals, formulas most destructive of interstate commerce would be sanctioned. For example, the state wherein an association member manufactures devices could adopt a single factor cost-of-manufacture formula, which would meet the Court of Appeal's standard equally as well as the District's single factor destination-of-sales formula; yet the combination of the two would tax 200% of the net income from this commerce.

EIA has an interest in this case by reason of the substantial effect that the decision of the Court of Appeals will have on the business of its members with District customers, and because of the potential effect of the decision on their commerce in other states. Applicant wishes to show the effect on its members of the constitutional issue presented, and to urge this Court to grant a writ of certiorari to clarify this important area of constitutional law.

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DISTRICT OF COLUMBIA, *Respondent*.

BRIEF AMICUS CURIAE OF ELECTRONIC INDUSTRIES ASSOCIATION

QUESTIONS PRESENTED

Whether, for purposes of the District of Columbia Income and Franchise Tax of 1947, the apportionment of net income from sales by means of a single-factor sales formula which has the effect of allocating all of the net income from sales of goods to the jurisdiction to which the goods are delivered, violates the due process clause of the fifth amendment and the commerce clause of the U.S. Constitution in the case of a foreign corporation which manufactures goods at a point outside the District and ships a portion thereof to vendees in the District.

ARGUMENT

The petition should be granted because of the importance to the national commerce of the question of fair apportionment of taxes paid by businesses engaged in interstate commerce. In *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450 (1959), this Court made it clear that the taxing power of the states reaches the net income from pure interstate commerce, subject only to two constitutionally imposed conditions; namely, (1) that the tax be non-discriminatory and (2) that it be fairly apportioned to activities within the taxing state forming sufficient nexus to support it. Later in the opinion, the Court stated that a fair apportionment assures that a state is exacting only a constitutionally fair demand, and that apportionment prevents the levying of net income taxes that discriminate against interstate commerce and "place it at a disadvantage relative to local commerce" (p. 462). The Court went on to acknowledge that, "apportionment formulas being what they are", (p. 462) this result is not always attained, but pointed out that no question of the fairness of the apportionment had been raised by either taxpayer.[1]

We read the Court's remarks as holding out the reasonable expectation that in later cases in which the point might be properly raised, the Court will consent to review the fairness of apportionment formulas, at least when the question raised deals with the boundaries or outer limits of unfairness.

The present case presents an instance in which the Court should fulfill that expectation. The recent Con-

[1] *Northwestern States Portland Cement Co.* v. *Minnesota; Williams* v. *Stockham Valves and Fittings, Inc.,* 358 U.S. 450 (1959).

gressional report on state taxation of interstate commerce [2] states on pages 552, 553, 556 and 557 that the one factor apportionment formula of the District of Columbia produces the largest departure from the norm of any of the 38 apportionments of net income found at the State level in this country. In this group of 38 jurisdictions, only two others beside the District of Columbia use single factor sales formulas, and in these States (Iowa and Missouri), the degree of unfairness that would otherwise be produced is ameliorated by the permission of separate accounting and by the omission of a significant percentage of sales to in-state destinations from the numerators of both formulas.[3]

The Court of Appeals, in the majority opinion on rehearing, observed (p. 63a of Appendix to Petition for Writ of Certiorari) that the District's one factor sales formula had the effect of apportioning the entire net income of General Motors from all sources, but did not have the effect of apportioning the income from District sales. Stated otherwise, the Court of Appeals found that the formula operated to divide the total income of the taxpayer into two parts, one representing income bearing a degree of connection (in some cases quite tenuous) with business carried on by the taxpayer in the District, and the other representing income unconnected with the District. The Court acknowledged that the portion representing

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[2] "State Taxation of Interstate Commerce," Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the House of Representatives, pursuant to P.L. 86-272, as amended, House Rep. No. 1480, 88th Cong., 2d Sess. (June 15, 1964).

[3] *Id.*, pp. A280, A281, and A308.

income related in some degree to the District was not further apportioned between the District and the other States in which occurred activities forming sufficient nexus to support a similar tax; *e.g.*, activities such as the manufacturing operations which produced the automobiles sold to District customers. The Court then held that the statute permitted the use of an apportionment of this type; *i.e.*, one which would allow the District to tax the whole of any portion of the income with which it had any degree of connection, however slight, and without regard to the fact that such portion was subject to an overlapping tax in other nondomiciliary states because of a degree of connection therewith.

The Court of Appeals then went on to hold in Sections IV and V of the opinion (pp. 66a-75a of the Petition for Writ of Certiorari) that this type of apportionment is not constitutionally invalid. In arriving at that conclusion, it stated or implied that the one factor sales formula was "a reasonable choice among alternative methods",[4] that it was not "operating indefensibly",[5] that it "reasonably" attributed income to the District.[6]

The question presented by this holding is therefore of great significance not only to the members of the Electronic Industries Association but to all multi-state taxpayers. Such an apportionment results in a relinquishment of a claim for a tax on income which is wholly unconnected with the jurisdiction, and claims tax on 100% of the income earned partially within and

[4] p. 70a, Petition for Writ of Certiorari.

[5] p. 71a, Petition for Writ of Certiorari.

[6] p. 73a, Petition for Writ of Certiorari.

partially without the jurisdiction, through interstate transactions taxable both there and in other States. If such an apportionment can be considered *constitutionally* fair and defensible, then interstate commerce is helpless to contest competing State revenue demands which result in actual double taxation and actual discrimination. We do not believe the apportionment upheld in this case can be described as fair under any meaning of that term.

CONCLUSION

We urge the Court to grant a writ of *certiorari* herein to resolve the substantial questions presented by the taxpayer's petition.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. 352

GENERAL MOTORS CORPORATION, *Petitioner*

v.

DISTRICT OF COLUMBIA, *Respondent*

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF FOR THE PETITIONER

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The findings of fact and opinion, as amended, of the District of Columbia Tax Court are not officially reported. The printed record (R. 436-473; 491-497) contains the Tax Court's original findings and opinion and its order modifying them. For the convenience of the Court, we have made the directed changes and printed the complete findings and opinion as modified in Appendix A hereto, p. 1a, *infra*. The majority

and dissenting opinions of a division of the Court of Appeals (O.R. 592) are not officially reported. The majority and dissenting opinions of the Court of Appeals on rehearing *en banc* (R. 498-532) are reported at 336 F.2d 885. The opinions modifying the judgments (R. 533-535) are reported at 336 F.2d 904.

JURISDICTION

The judgments, as modified, of the Court of Appeals were entered May 7, 1964, 336 F.2d 904 (R. 536). Petition for writ of certiorari was filed August 5, 1964, and granted October 26, 1964, 379 U.S. 887. The jurisdiction of this Court rests on 62 Stat. 928, 28 U.S.C. 1254(1).

QUESTIONS PRESENTED[1]

I. Interstate Commerce, Due Process and Territorial Jurisdiction

Whether the single-factor sales formula for the "apportionment" of net income, prescribed by the Commissioners of the District of Columbia purportedly under authority of the District of Columbia Income and Franchise Tax Act of 1947, is invalid:

(a) as repugnant to the Due Process Clause of the Fifth Amendment to the Constitution;

(b) as repugnant to the Commerce Clause of the Constitution; or

(c) as unconstitutionally extending the power of the Commissioners beyond their territorial jurisdiction;

when the application of such formula results in the taxation by the District of 100 percent of the net in-

[1] Reprinted verbatim from the petition.

come of a foreign corporation derived from that segment of its business consisting of the manufacture and sale of products without the District to customers within the District, thus

(1) taxing extraterritorial values and assigning to the District values which belong to, and have been properly taxed by, other states;

(2) imposing upon interstate commerce cumulative tax burdens (double taxation) to which local commerce is not subject; and

(3) subjecting to District tax an amount of income out of all reasonable proportion to the business actually "carried on or engaged in" within the District.

II. Statutory Construction

Whether the District of Columbia Income and Franchise Tax Act of 1947, which imposes a franchise tax on corporations carrying on business within and without the District, measured by net income "fairly attributable" to District business, permits the adoption by regulation of the District Commissioners of a single-factor sales formula to determine the amount of such taxable income, when the application of such formula subjects to District tax 100 percent of the net income of a foreign corporation derived from that segment of its business consisting of the manufacture and sale of products without the District to customers within the District, a percentage which is out of all reasonable proportion to the business carried on within the District.

CONSTITUTIONAL PROVISIONS, STATUTES, AND REGULATIONS INVOLVED

Art. I, § 8, cl. 3 of the Constitution of the United States and the Due Process Clause of the Fifth Amendment thereto are set forth in Appendix B-1, p. 30a, *infra*.

The pertinent sections of the District of Columbia Income and Franchise Tax Act of 1947, being §§ 47-1551c(h), 47-1580 and 47-1580a of the D.C. Code 1961, are set forth in Appendix B-2, p. 30a, *infra*.

The pertinent sections of the District Commissioners' Regulations of August 6, 1953 (as relettered by amendment of July 24, 1956), and an excerpt from the Regulations of July 14, 1961, are set forth in Appendix B-3 and B-4, p. 33a, *infra*.

The pertinent sections of the laws of Delaware, Maryland and Michigan are set forth in Appendix B-5, p. 38a, *infra*.

STATEMENT OF THE CASE

Petitioner, General Motors Corporation, brought proceedings in the District of Columbia Tax Court for the review of franchise tax deficiencies for the taxable years 1957 and 1958 assessed by respondent, District of Columbia, purportedly pursuant to the District of Columbia Income and Franchise Tax Act of 1947 (D.C. Code 1961, §§ 47-1551 *et seq.*); and for refund of the taxes and interest so assessed and paid under protest (O.R. 1-37).

Petitioner is a Delaware corporation, qualified to do business in the District (R. 372). In the taxable years involved, it was engaged principally in the manufacture and sale of motor vehicles, parts and acces-

sories. Such manufacture was carried on wholly outside the District (R. 261) and, as to the products sold and shipped to District customers, very largely in Michigan, Delaware and Maryland (R. 437). Petitioner's products were sold to customers (principally automobile retail dealers) whose places of business were in the District; the orders were received and filled, and title passed, outside the District, and the products were shipped to the customers from outside the District (R. 261-300, 504). Not only the entire manufacturing activity but most of the selling activity was carried on outside the District. With very minor exceptions, the sales offices were outside the District.[2] Personnel from those outside offices, none of whom resided in the District, regularly called on customers in the District for promotional purposes and assisted in improving their operations (R. 262-282, 294-300).[3] Several small offices were maintained in the District (*e.g.*, a public relations office, a patent office, and certain offices for government contract liaison), but their

[2] United Motors Service Division had a Zone Office in the District in 1957 and during the first six months of 1958, its sales being the basis of the tax originally paid by petitioner (R. 294, 373). Chevrolet Division maintained in the District a Regional Office, which had one employee whose duties were to assist fleet users throughout the Region in several states, and where one employee of the Zone Office (located in Baltimore) was assigned space. Except for these employees, the office itself performed no functions directly related to sales, but provided administrative supervision over five Zone Offices located outside the District (R. 270-271).

[3] The Court of Appeals dwelt at some length on the activities of petitioner's sales personnel in the District (R. 506-509). It may help to put such activities in perspective to note that the total amount of compensation allocable to the time which all such transient personnel (making regular visits to the District one or more times a month) spent in the District was $65,099 in 1957 and $75,694 in 1958 (R. 387).

presence had no bearing on the amount of the assessments (R. 285-294, 300-306).

Petitioner's customers, who are independent businessmen, operate under dealer selling agreements which prescribe certain standards of management and performance (R. 282-284, 296, 300, 307-346, 505). In certain instances, petitioner and a subsidiary provide financing for dealers (R. 302-304, 347-371, 384, 505-506). The dealers pay District taxes on their own profits; and petitioner and its subsidiary have paid taxes without controversy on income from financing the dealers (R. 375). The nature of petitioner's relationship to the dealers is not in issue in this case.

The District of Columbia Income and Franchise Tax Act of 1947, *supra*, imposes a tax on the privilege of carrying on business within the District,[4] measured by the portion of net income fairly attributable to the District business, leaving the determination of such portion to regulations of the Commissioners.[5] The Commissioners prescribed a formula under which the total net income was multiplied by a fraction the numerator of which comprised "District sales" and the denominator of which was total sales everywhere.[6] As applied by the Finance Officer, "District sales" was treated as embracing all sales in which the goods were shipped to a District customer at a location in the

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[4] It is not denied that petitioner was carrying on business in the District and that the District has jurisdiction to tax.

[5] D.C. Code 1961, §§ 47-1580, 1580a, App. B, pp. 31a-33a, *infra*, Part IV of the Tax Court's opinion contains a helpful discussion of the history of the statute (R. 447-450; App. A, pp. 13a-16a, *infra*).

[6] Appendix B, p. 33a, *infra*.

District (R. 372-374).[7] In other words, he determined and taxed the total profit realized on all business culminating in sales to customers located in the District (on the assumption, valid for this purpose, that each sale was equally profitable). This method is referred to herein as a "single-factor sales formula" using the "destination sales" test, in contrast to apportionment formulae which take into account the contribution of capital and labor to the production of income.

The District accordingly assessed deficiencies for the years 1957 and 1958 (R. 372-375). After exhausting its administrative remedies, petitioner paid under protest the assessed deficiencies, together with interest thereon, and brought proceedings in the District of Columbia Tax Court for review of the assessments and for refund of the taxes and interest paid (R. 375-376).

In addition to the facts stipulated, the Tax Court made the following *findings of fact:* Petitioner's central offices were in Michigan and New York. It had business establishments in 38 states and the District. Finding 1, R. 437; App. A, p. 1a, *infra.* There was no factory in the District. About half of all manufacturing activities were in Michigan. The vehicles sold to District customers were manufactured principally in Michigan, Maryland and Delaware. Finding 2, R. 437; App. A, pp. 1a-2a, *infra.* The segment of petitioner's business which was conducted both within and without the District consisted of the manufacture of motor

[7] Petitioner had originally paid tax on the basis of a different interpretation of what constituted "District sales" within the meaning of the regulation. That question of applying the regulation to the facts is not before this Court, but will be determined on remand if this Court upholds the regulation (R. 533-535).

vehicles and related products without the District and their sale to customers located within the District. The net income from this segment of the business was earned by a series of transactions, including procurement of material, use of property, financing and manufacture in various states and ending with sales to customers located in the District. Finding 5, R. 495-496; App. A, p. 3a, *infra*. The single-factor sales formula used in determining taxable net income assigned to the District 100 percent of the net income arising from that segment of the business and was out of all reasonable proportion to the trade or business carried on or engaged in by petitioner in the District. Finding 6, R. 496; App. A, p. 3a, *infra*. A portion of the net income derived from that segment of the business consisting of the manufacture without the District and sale to dealers in the District was taxed in Michigan, Maryland and Delaware, the states of manufacture, pursuant to apportionment formulae provided in their income-based tax laws. The taxes so paid were $510,792.31 to Maryland and $8,955,799.55 to Michigan in 1957, and $127,844.95 to Delaware, $271,425.75 to Maryland and $6,940,309.50 to Michigan in 1958. Findings 3(a), 3(b), R. 437-438, 495; App. A, p. 2a, *infra*.[8]

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[8] There are numerous places in the findings and opinion of the Tax Court, in the opinion of the Court of Appeals, in the record and in the briefs, where there appear such phrases as "sales within the District" and "manufactured without but sold within the District". These are convenient shorthand, but it must be understood, as it was by the parties and both courts below (R. 192, 228, 504) that "sales [or sold] within the District" means only that the customers were located in the District, and does not refer to any selling activity of petitioner within the District. Every element of most sales took place outside the District, and the only related in-District activity was the liaison work of traveling personnel (R. 266, 268, 269, 270, 276, 280, 281, 295, 299).

Based on such findings, which the District did not challenge in the Court of Appeals (except for the ultimate conclusions), the Tax Court held that on the record the single-factor sales formula as applied produced an arbitrary and unreasonable result, violating the apportionment provisions of the Act (D.C. Code 1961 §§ 47-1580, 47-1580a), since the formula *identified,* but did not *apportion,* the income derived from petitioner's business conducted within and without the District. Thus it invalidated the formula as applied and redetermined the tax deficiencies using a three-factor formula of property, payroll and sales, each factor receiving equal weight, as the method best suited to determine the portion of petitioner's business income subject to tax. It did not reach the constitutional questions raised. (R. 436-473, 491-497; App. A, p. 1a, *infra.*)

The District appealed the Tax Court decisions to the Court of Appeals for the District of Columbia Circuit. On February 21, 1963, a division of the court, one judge dissenting, affirmed the Tax Court (O.R. 592). That court granted, on April 18, 1963, the District's petition for rehearing *en banc,* and on February 13, 1964, five judges reversed the decisions of the division and of the Tax Court and affirmed the deficiency assessments, deciding the statutory and constitutional questions adversely to petitioner (R. 498-527). Four judges dissented, one concurring in part (R. 528-532). Petitioner timely filed on February 25, 1964, a petition for rehearing to modify the judgments of February 13, 1964, which petition was granted on May 7, 1964. The judgments, as modified, sustain the use of the single-factor sales formula but leave for subsequent determination what sales are "District sales" (R. 533-535).

SUMMARY OF ARGUMENT

The case presents two questions: whether the assessments are a permissible construction of the statute; and whether they transcend constitutional limitations. In our petition for certiorari we put the constitutional aspects first because of their greater importance to this Court, and that order is carried over into our statement of Questions Presented (p. 2, *supra*). However, in the light of this Court's well-settled doctrine that it will not reach constitutional questions when the case can be decided on statutory grounds, we have reversed the order of argument in this brief on the merits. Much of the material pertinent to both sections of the brief appears in the statutory section and is not repeated in the constitutional section.

I. The Assessments Are Contrary to the Statute

The District of Columbia Income and Franchise Tax Act of 1947 clearly contemplates confining the tax base to net income derived from or "fairly attributable" to business activities carried on in the District. The location of customers has little or nothing to do with the place where such activities are carried on. In applying to petitioner's total net income the ratio of receipts from sales to customers in the District to receipts from sales everywhere, the Finance Officer accomplished no more than to identify the *entire* net income from that segment of petitioner's business culminating in sales to District customers, which segment of the business was almost entirely carried on in other jurisdictions (where the products were manufactured and the sales themselves were consummated).

The formula so applied did not *apportion* the net income from such business, as the statute directs. An

"apportionment" is not accomplished merely by dividing the entire net income into taxable and nontaxable parts, exempting from tax the part having no connection whatever with the District, and taxing in its entirety the net income having even the most limited and partial connection with the District. Nothing in the legislative history indicates that Congress approved or intended such method of determining the taxable net income.

II. The Assessments Are Unconstitutional

If, however, the statutory grant of power to the District Commissioners to provide apportionment formulae by regulations is construed to be broad enough to permit what was done, the regulations are unconstitutional. The Due Process and Commerce Clauses of the Constitution prohibit the District Commissioners, as well as the states, from taxing transactions and values beyond their territorial jurisdiction. Taxation of the net income from interstate business is permitted only when such net income is fairly apportioned among the jurisdictions where the income was produced. It is established by expert testimony and findings of fact herein, and as a matter of law by this Court, that income is derived from labor, capital or both combined. It is further established as a fact in this case that petitioner's income which the District assessed is derived primarily from manufacturing (and selling) activities without the District, and that the contribution of each productive element at each location can with acceptable accuracy be measured by the costs thereof. Applying such measures shows clearly that the assessments (a) are grossly excessive in relation to activities within the District, and (b) reach values outside the territorial jurisdic-

tion of the District, for which reasons they are repugnant to the Due Process and Commerce Clauses.

Substantial portions of the same income which the District has assessed have been properly taxed in other states. The resultant double taxation is the fault of the peculiar method of "apportionment" used by the District, and under these facts is a constitutionally forbidden discrimination against interstate commerce.

If the decision below is upheld, other states will be encouraged to adopt the single-factor sales formula in order to gain competitive advantages for local producers and to impose discriminatory tax burdens on outside corporations, large and small, which sell into such states. The Constitution forbids the use of the taxing power for the purpose of establishing economic barriers against interstate competition.

ARGUMENT

I. THE ASSESSMENTS ARE CONTRARY TO THE STATUTE

Statutes and Regulations Involved

The District of Columbia Income and Franchise Tax Act of 1947 (D.C. Code 1961 §§ 47-1551 *et seq.*) imposes a "franchise tax upon every corporation . . . for the privilege of carrying on or engaging in any trade or business within the District", measured by "that portion of the net income of the corporation . . . as is fairly attributable to any trade or business carried on or engaged in within the District".[9] If the

[9] D.C. Code 1961 § 47-1580, App. B, p. 31a, *infra*. In addition, the tax applies to "other income . . . derived from sources within the District", which is "allocated" entirely to the District and is not included in the apportionable income here involved. Such "other income", consisting of dividends, interest and rentals from District sources, has been taxed in this case (R. 375, 460-461) and

business "is carried on or engaged in both within and without the District, the net income derived therefrom shall . . . be deemed to be income from sources within and without the District", and "the portion thereof subject to tax . . . shall be determined under . . . regulations prescribed by the Commissioners".[10]

There can be no complaint about the statute itself. The fault lies in the exercise of the delegated power by the Commsisioners. Their power to prescribe an apportionment formula is not unlimited;[11] the formula must be one which will "properly determine" the taxable income[12]—*i.e.*, the income "fairly attributable" to business carried on or engaged in *within* the District. An apportionment regulation which fails to make a "fair and just division" is unauthorized and invalid. *Manhattan General Equipment Co.* v. *Commissioner*, 297 U.S. 129, 134.

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is not in controversy. Respondent made some argument below that business income realized through sales to District customers, if partially excluded from taxable income by an apportionment formula, was nevertheless taxable in full as "other income". The Court of Appeals (R. 512-513, n. 16) found it unnecessary to reach this question, but it noted that it had previously held that the categories of apportionable business income and "other income" are mutually exclusive, citing *District of Columbia* v. *Evening Star Newspaper Co.*, 106 U.S. App. D.C. 360, 367, 273 F.2d 95, 102.

[10] D.C. Code 1961 § 47-1580a, App. B, pp. 32a-33a, *infra*.

[11] The District Commissioners derive their legislative powers solely by delegation from Congress (*District of Columbia* v. *John R. Thompson Co.*, 346 U.S. 100), and such powers must be exercised within the limits of the delegation. *McCeney* v. *District of Columbia*, 97 U.S. App. D.C. 282, 285, 230 F.2d 832, 835; *Thompson* v. *Amalgamated Casualty Ins. Co.*, 92 U.S. App. D.C. 307, 314, 207 F.2d 214, 220.

[12] D.C. Code 1961 § 47-1580a, App. B, pp. 32a-33a, *infra*.

Over thirty states having similar tax laws have been able, either by statute or by regulation, to find reasonable bases for the apportionment of such income.[13] Instead of following any of these precedents, the District has sought to tax much more than its fair share of the income of any business which in any way touches the District.

The formula adopted in the regulation assigns to the District that percentage of the corporation's entire net income that "the District sales . . . bear to the total sales made everywhere. . . . 'District sales' shall mean all sales to District customers the income from which is fairly attributable to the trade or business carried on or engaged in within the District. . . ."[14] In applying that regulation, the respondent construed "District sales" to mean all sales to customers located in the District, regardless of all other considerations (R. 374). This, in tax parlance, is known as the "destination sales" test. It assumes, as some of the District's witnesses testified (R. 182-185, 194-195, 204-205; see discussion, pp. 15-16, *infra*), that net income is "fairly

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[13] The best available study and summary of income apportionment for tax purposes is contained in the June 1964 Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the House of Representatives, House Report No. 1480, 88th Congress, 2d Session, in Chapters 5 and 7, especially pp. 113, 116-123, 168-170, 180-183, 235-236, 246-249. As shown therein (p. 119), 26 states use three-factor formulae based on property, payroll and sales; several others use something similar; and four (perhaps 3, see pp. 116-117), including the District, are shown as using sales alone. We believe, however, the District is the only one which exclusively and rigidly applies the customer location test, the others by administrative discretion (pp. 235-236) or otherwise having somehow managed to hold their sales (or substitute) measure to reasonable relationships to *activities*.

[14] App. B, p. 33a, *infra*.

attributable" in its entirety to the customer and his location, and in no part to manufacturing, selling, and other activities which take place elsewhere.

Character of Apportionable Income

Petitioner's total income to be apportioned is derived from business conducted by it (1) wholly outside the District (involving products both manufactured and sold elsewhere) and (2) both within and without the District (products manufactured elsewhere and sold to customers located in the District). The figure obtained by multiplying petitioner's total net income by the ratio which District sales bear to total sales affords the best available measure of the *total net income* realized from all business culminating in sales to District customers. Respondent's witness Watson testified that, as an economic matter, "the net income from any one batch of sales . . . is proportionate to the net income from any other batch of sales" (R. 172). The District's formula, in effect, applies an average rate of profit to all sales and thereby determines the total profit from all business culminating in sales to District customers.[15]

That calculation, however, attributes none of such income to activities carried on elsewhere with respect to products sold to District customers. For example, petitioner's witness, Morton, testified (R. 211):

> Q. ". . . I want to ask you to describe what is the result of applying this fraction, the numerator of which is District sales, the denominator of

[15] Such a calculation, though it might be used as a starting point for an apportionment, is unnecessary for that purpose. The apportioning fractions can be applied directly to the *entire* net income from all sources. Pp. 20-23, *infra*.

which is the total sales, to the total net income of the corporation?"

A. "The result is to ascribe all of the income arising from the business involved in the sales to the District of Columbia to the District of Columbia. That is, it ascribes 100 percent of the income arising through all of the processes that produce the sales to the District of Columbia."

Clearly, "carrying on trade or business" includes not only the final act of sale,[16] but also all those productive activities outside the District preliminary to the sale, without which there could be no sale and no income (Finding No. 5, R. 495-496; App. A, p. 3a, *infra*). The sales formula thus has no inherent tendency to accomplish the statutory division of income, *viz.*, a determination of that portion "fairly attributable" to petitioner's business activities carried on in the District.

Tax Court Decision

The Tax Court sustained petitioner's position that the sales formula was not authorized by the statute, since it merely *identified*—and did not thereafter apportion—the amount of net income derived from that segment of petitioner's business conducted both within and without the District culminating in sales to District customers, segregating it from income derived from petitioner's business conducted wholly without the District (R. 441-447; App. A, pp. 6a-13a, *infra*). Further, the Tax Court pointed out that the formula improperly exempted from tax the income derived

[16] Even this final act normally occurred outside the District. Orders from dealers were received and filled, and title passed, outside the District (R. 266, 268, 269, 270, 276, 280, 281, 295, 299, 504). "Trade or business" includes "any . . . commercial activity." D.C. Code, 1961, § 47-1551c(h), App. B, p. 30a, *infra*.

from business activities within the District but not related to sales to District customers (R. 445, 459; App. A, pp. 10a-11a, 25a, *infra*).[17] The formula thus did not follow the statutory mandate that where the net income is derived from business carried on *within and without* the District, it is deemed to be from sources *both* within and without and must be apportioned to tax only that income "fairly attributable" to business carried on *within* the District.[18]

Instead, the formula allocated to the District 100 percent of the net income derived from the segment of petitioner's business involved in the manufacture of products without the District and their sale and shipment to customers located within the District (R. 496; App. A, p. 3a, *infra*). Clearly, a portion of such income is fairly attributable to petitioner's related out-District activities involved in the manufacture-distribution process (R. 496; App. A, p. 3a, *infra*).

On this point the testimony of the District's witness Nathan is revealing. He was asked on cross-examination whether, assuming petitioner manufactured solely in Michigan and sold its entire output to District cus-

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[17] For example, the District formula attributes none of petitioner's income to its District business carried on in offices in the the District whose activities (patents, public relations, etc.) were unrelated to its "District sales" (R. 304-306). Such activities made some contribution to the net income of petitioner, which income the statute deems to be derived partly from within the District and partly from without. The assessments put it all without. It does not matter that the deviations from the statute are in opposite directions and thus tend to offset. Each is a plain violation and the offset is very minor.

[18] D.C. Code 1961, §§ 47-1580, 47-1580a, App. B, pp. 31a-33a, *infra*.

tomers, any of the income therefrom was earned in Michigan (R. 202). He answered:

> "Certainly in part [it] is attributable to every aspect of economic activity and to the extent the [District sales] formula would put *all* the net income in the District of Columbia, to that extent one might say that it deviates from some rational allocation taking into account as many factors as one conceivably could . . ." (R. 202, emphasis added).

He also testified that the sales formula achieves the same result when only a *segment* of the manufacturer's total sales are to District customers (R. 194-195, 204-205), *viz.*, 100 percent of the income derived from that *segment* is taxed in the District, regardless of the geographical distribution of the taxpayer's related income-producing activities.

When the Tax Court asked Mr. Nathan whether a 100 percent attribution to the District is fair when related income-producing activities (manufacturing) are elsewhere, he answered: "I say that it is a fair approximation even though in that specific instance it does appear to violate what one would call fairly attributable—" (R. 204). We submit that he, like the Tax Court, fully recognized that the sales formula as here applied did not comply with the statute (R. 206-208). Professor Watson, another witness for the District, was candid in making the same admission: "Then my answer is that my testimony is inconsistent with the law" (R. 185; see also R. 182-185).

Errors of Statutory Construction by the Court of Appeals

In regard to the relationship between the taxed income and petitioner's District activities, the Court of Appeals has made two fundamental errors, both arising from the same point. In making the first error, the majority argues that petitioner's *entire* income, (a) from business conducted within and without the District, *and* (b) from business conducted wholly without the District, is to be apportioned; and that since the formula applied by the District excludes class (b) from tax, it is proper to allocate *all* of class (a) to the District.

The Tax Court had pointed out the fallacy of this reasoning and emphasized it by noting that, if a corporation's entire manufacturing operation took place in Maryland and its entire product was sold in the District, the approach used in these assessments would assign 100 percent of the net income to the District in direct conflict with the statutory command that such income be deemed to be derived from sources both within and without the District and apportioned accordingly (R. 444; App. A, p. 10a, *infra;* see discussion, pp. 16-18, *supra*). Assume, for example, that the corporation's net income from such business in 1957 is $100,000. The statute clearly requires that such income be deemed to be derived in part from Maryland and in part from the District, and only that part "fairly attributable" to business done in the District may be taxed there. Any regulation or assessment which taxes 100 percent as "fairly attributable" to the District is obviously wrong, and presumably the Court of Appeals majority would agree that the required apportionment had not been made. If by

an apportionment formula, or separate accounting, or some other acceptable method, it is determined that the correct portion is $25,000, the District is entitled to tax that much and Maryland the balance.

Now assume that in 1958 the corporation establishes a new factory in Pennsylvania, manufacturing a different product and selling it entirely to Pennsylvania customers, earning another $50,000 net income, while the Maryland-District business remains the same. It should be clear that income taxable in the District remains at $25,000, while Maryland has $75,000 and Pennsylvania $50,000. But the Court of Appeals holds that because the District did not tax the Pennsylvania income, the only requisite "apportionment" has been made, and the District may now tax 100 percent of the Maryland-District income (*i.e.*, $100,000).

The court's second error (in this branch of the case) is in drawing from the foregoing reasoning (of petitioner and the Tax Court) the inference that petitioner contends the statute *requires* that segment net income (*i.e.*, that derived from all activities culminating in sales to District customers) be first segregated and then apportioned. We did not so contend; what we did and do contend is that *if* the computation of that income is to be made (pursuant to the regulation), it is only the first step in a proper apportionment. Subsequent steps, properly applied, would achieve the correct result, but by an unnecessarily cumbersome route. Both petitioner and the Tax Court fully agree with the Court of Appeals, however, that the best way is to apportion the *entire* net income; not just the segment. The parties stipulated the total amounts of apportionable net income (R. 375), and the

Tax Court's computations were on that basis (R. 459-462).

What the Court of Appeals overlooks is that the statutory division of income can be achieved *either* by finding the amount of income related to "District sales" and apportioning that amount, *or* by apportioning entire net income, *and under any true apportionment formula the result will be exactly the same.* This was illustrated in our brief in a tabulation, using actual figures, which showed exactly why that is so.

The tabulation is reprinted in Appendix E hereto. To make the point more simply, the following is a hypothetical example, assuming for illustration only that apportionment should be on the basis of a property ratio (as was approved by this Court in *Underwood Typewriter Co.* v. *Chamberlain,* 254 U.S. 113, and *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission,* 266 U.S. 271):

Total sales (Gross receipts)	$1,000,000
Total net income	100,000
Total property	1,000,000
Sales to District customers	100,000
Property in District	10,000

Then, under the *Underwood Typewriter* and *Bass, Ratcliff & Gretton* formulae: Since 1 percent ($10,000) of the total property ($1,000,000) is in the District, 1 percent ($1,000) of the total net income ($100,000) is attributable to the District. The same result is achieved by assuming, as the District did (quite properly), that the net income from each equal segment of the business is the same—*i.e.*, that net income from manufacture and sale of goods sold to District cus-

tomers is in the same ratio as such (segment) sales to total sales—and the necessary corollary that the use of property is similarly proportioned: Since 10 percent ($100,000) of total sales ($1,000,000) are to District customers, the net income from manufacturing for and selling to District customers is 10 percent ($10,000) of total net income ($100,000), and the property used to produce such segment income is 10 percent ($100,000) of the total property ($1,000,000); and, since 10 percent ($10,000) of the property so used ($100,000) is in the District, 10 percent ($1,000) of such segment income ($10,000) is attributable to the District.

The assumption which the Court of Appeals makes is clearly incorrect: Because 10 percent of sales are to District customers, 10 percent of net income is fairly attributable to District activities. That would be true only if income-producing activities were by coincidence distributed in the same proportions as customers. They are not, as the entire record shows. The proper assumptions are those shown above.

The relevance of the discussion of segmenting petitioner's income is that it affords a test of the fairness of the formula used by respondent. It demonstrates that such a formula, unlike the single-factor *property* formula involved in *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121, "reached and was meant to reach" profits earned by activities outside the District. While wide latitude is allowed the taxing authorities in their choice of apportionment formulae, a so-called formula which demonstrably accomplishes no more than to identify the *total* net profits derived from products sold to District customers and in every

case taxes 100 percent of that amount is incapable of achieving a fair apportionment of income to District business activities.

The majority below thus held that an "apportionment" was made because the *entire* net income from all business was divided into taxable and nontaxable portions based on the location of customers (R. 511-517). If that view were sound, any so-called formula that taxed in the District less than 100 percent of petitioner's entire income (even 99 percent thereof) would be upheld as making an "apportionment". That view, however, ignores the requirement that the apportionment "properly determine" the amount "fairly attributable" to District business. The fact that the formula adopted succeeds in excluding from taxable income the portion having *no connection whatever* with the District does not suffice, when the formula designedly taxes 100 percent of the portion having even *the most limited and partial connection* with District activities. "And not only must a regulation, in order to be valid, be consistent with the statute, but it must be reasonable. . . ." *Manhattan General Equipment Co.* v. *Commissioner,* 297 U.S. 129, 134-5. The District's formula could achieve a proper apportionment only by coincidence, *viz.,* if the taxpayer's income-producing activities happen to be geographically distributed in the same proportions as are its customers.

The conflict within the Court of Appeals is well illustrated by contrasting the decision below with that in *Broadcasting Publications, Inc.* v. *District of Columbia,* 114 U.S. App. D.C. 163, 313 F.2d 554, which involved a periodical published in the District, with

97 percent of its circulation in other jurisdictions.[19] The Tax Court, relying on *District of Columbia* v. *Evening Star Newspaper Co.*, 106 U.S. App. D.C. 360, 273 F.2d 95, divided the income according to the location of the customers. But the Court of Appeals, minimizing the importance of that consideration, stressed the productive operations which "are the main elements . . . from which a formula of allocation must be derived," and the need to identify the "function which fairly reflects the geographical sources of income" (313 F.2d at 559). Accordingly, the Court of Appeals concluded that the entire income of the taxpayer was taxable in the District, where almost all its productive activities and facilities were concentrated. A comparison of the facts of the two cases shows that *every consideration which brought Broadcasting Publications into the District puts petitioner outside the District.* See the tabulation in App. D, p. 51a, *infra*, which was presented to the Court of Appeals on reargument.

[19] Such conflict is understandable in view of the District's efforts "to work both sides of the street." It is a fair conclusion from the decided cases that the District has varied the meaning of the "fairly attributable" standard of the regulations of August 6, 1953 (App. B, pp. 33a-34a, *infra*) to maximize the tax rather than to make a fair apportionment, *e.g.*, *Smoot Sand & Gravel Co.* v. *District of Columbia*, 104 U.S. App. D.C. 292, 261 F.2d 758; *District of Columbia* v. *Evening Star Newspaper Co.*, 106 U.S. App. D.C. 360, 273 F.2d 95; *Broadcasting Publications, Inc.* v. *District of Columbia, supra.* See also memorandum of March 22, 1961 from the District Finance Officer to the Commissioners attached as Appendix A to the Tax Court's opinion (R. 463-468), in which the Finance Officer describes the administrative difficulties encountered in trying fairly to apply the sales formula. The unfairness of the July 14, 1961 amendments to the regulation (App. B, pp. 34a-38a, *infra*) is described in the Tax Court's Memorandum on Remand in *Gallant, Inc.* v. *District of Columbia*, CCH D.C. Tax Rep., ¶ 200-004, pp. 10,014-10,016.

There can be differences of opinion as to what constitutes a reasonable test of "fairly attributable", but it is clear at least that any such test must work both ways—*i.e.*, if certain circumstances occurring within the District make income "fairly attributable" to the District, those same circumstances occurring without the District make that income "fairly attributable" to some place without the District and not "fairly attributable" to the District. There can be no doubt that the "main element" of petitioner's business is manufacturing (including purchasing, engineering, designing, financing and general management), which is conducted entirely outside the District (R. 261) and is unquestionably the "function which fairly reflects the geographical sources" of petitioner's income.

The Court of Appeals argued (R. 515-516) that Congress must be deemed to have approved the use of the single-factor sales formula because a similar formula had been used under an earlier gross receipts tax and "any intended change in application would have been indicated clearly by Congress". That is a complete *non sequitur*. The gross receipts tax had expired in 1939, eight years before the present tax was enacted, so there was no occasion to indicate an "intended change in application". Furthermore, it was an entirely different kind of tax, not apportioned by formula at all but imposed on "the gross receipts received from any business in the District of Columbia". 50 Stat. 673, 688, § 1(e); *Neild* v. *District of Columbia*, 71 U.S. App. D.C. 306, 110 F.2d 246. In the interim, there had been in effect since 1939 a net income tax, under which it is true that the apportionment formula was based on the sales ratio, but the sales taken into account were very different from those used under

the present formula, since only sales in which title passed in the District were included. *Electric Storage Battery Co.* v. *District of Columbia,* 81 U.S. App. D.C. 135, 155 F.2d 867. That test in practical effect excluded from tax the entire income from many sales by outside parties to District customers, such as the respondent now seeks to tax.

Congress, in adopting the 1947 Act here involved, made a very substantial change in the concept of the place of sale, by removing the passage-of-title test. *Lever Bros. Co.* v. *District of Columbia,* 92 U.S. App. D.C. 147, 151-2, 204 F.2d 39, 43-4. But it does not follow that it made a complete turnabout and authorized taxation of the entire income of a manufacturing and selling business at the place where the customer was located. In place of the arbitrary passage-of-title test, Congress prescribed a new standard, that the tax (so far as business income is concerned) must be measured by that income which is "*fairly attributable* to any trade or business carried on or engaged in within the District" (emphasis added). This was an entirely new test, which required that consideration be given to where the *business* is carried on or engaged in, and that the regulations determine what portion of the income may fairly be attributed to the business done in the District. See Tax Court opinion, R. 447-450; App. A, pp. 13a-16a, *infra.*

Perhaps the most significant change in statutory language which the 1947 Act made was the addition of the express requirement that

> "If the trade or business of any corporation is carried on or engaged in both within and without the District, the net income derived therefrom *shall,* for purposes of this article, *be deemed to be income from sources within and without the Dis-*

trict." D.C. Code 1961, § 47-1580a, App. A, *infra*, p. 32a. (Emphasis added.)

In the light of the legislative history, it is clear that Congress intended by this provision to prevent the use of such arbitrary criteria as location of customer and passage of title to pull all income from an interstate sale into the District or push all of it out, and instead to require an *apportionment.*

We have searched the legislative history in vain for any indication of Congressional intent that would support the theory of the statute adopted in the Commissioners' regulation. In the absence of such intent, and in the light of the grave constitutional questions that would be raised by any such interpretation (see pp. 28 *et seq., infra*), the statute should be read as we contend. Such a reading would, in fact, carry out the true Congressional intent—that of apportioning to each jurisdiction its fair share, but not an excessive or unduly overlapping amount, of tax.

II. THE ASSESSMENTS ARE UNCONSTITUTIONAL

A. The Assessments Are Out of All Reasonable Proportion to Business Done in the District

Constitutional Restraints

The Income and Franchise Tax Act was enacted by Congress in its capacity as the local legislature for the District of Columbia. *Gibbons* v. *District of Columbia,* 116 U.S. 404; *Mercury Press, Inc.* v. *District or Columbia,* 84 U.S. App. D.C. 203, 173 F.2d 636, *cert. denied,* 337 U.S. 931. The apportionment formula was adopted by the District Commissioners, purporting to act under delegated powers. In exercising

the power of legislating for the District, Congress (and, *a fortiori*, its delegate) is restrained by the provisions of the Bill of Rights, including the Due Process Clause of the Fifth Amendment, which is essentially the same as the corresponding clause of the Fourteenth Amendment, applicable to the states. *Bolling* v. *Sharpe*, 347 U.S. 497, 499; *Hamilton National Bank* v. *District of Columbia*, 185 U.S. App. D.C. 109, 176 F.2d 624. The decisions of this Court, therefore, concerning the constitutional restraints on state taxation of extraterritorial values are pertinent to the present case.[20]

It is fundamental that the Due Process Clause precludes a state from taxing transactions and values beyond its territorial jurisdiction. *Wallace* v. *Hines*, 253 U.S. 66; *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 342.[21] As applied to local taxes imposed upon or measured by the net income of a multistate business, that principle means that there must be a fair apportionment of the income earned within and without the jurisdiction. *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 462-463; *Hans Rees'*

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[20] Much of the reasoning by which it appears that the assessments are contrary to the statute, set forth in the preceding section, applies equally to show that they are constitutionally offensive to due process requirements and therefore is not repeated here.

[21] Furthermore, even apart from the specific constitutional protection of "due process", a state may not reach transactions outside its territorial jurisdiction. *New York, Lake Erie & Western R. R. Co.* v. *Pennsylvania*, 153 U.S. 628, 646; *Miller Bros.* v. *Maryland*, *supra*, 347 U.S. at 342. The District Commissioners have no greater power.

Sons, Inc. v. *North Carolina,* 283 U.S. 123. It is, of course, recognized that a specific and precise allocation of the income of a unitary business among the states in which it functions is neither practicable nor required, and that resort to apportionment formulae is ordinarily essential. An apportionment formula may not, however, be used as a cloak for taxing extra-territorial values, and the tax will not be upheld (1) if the formula is intrinsically arbitrary or (2) if it reaches an unreasonable and arbitrary result in the particular case. *Hans Rees' Sons, Inc.* v. *North Carolina,* 283 U.S. 123, 134-135. *Cf. Fargo* v. *Hart,* 193 U.S. 491, 499-500; *Wallace* v. *Hines,* 253 U.S. 66.

Although this Court has several times considered the constitutional validity of apportionments of net income for state tax purposes, this is the first time the Court has been confronted with a decision in which an appellate court has upheld the constitutionality of an apportionment formula in the face of a square finding by the trier of the facts, based upon a record which "overwhelmingly sustains" such finding,[22] that the percentage of income subjected to tax was "out of all reasonable proportion to the trade or business carried on or engaged in by petitioner within" the taxing jurisdiction (Finding No. 6, R. 496; App. A, p. 3a, *infra*).

History of Relevant Decisions

The first case in which this Court was confronted with the question of the constitutionality of an apportionment of net income was *Underwood Typewriter*

[22] See dissenting opinion of Judges Danaher, Miller and Bastian in the Court of Appeals (R. 530).

Co. v. *Chamberlain*, 254 U.S. 113.[23] That case involved a Connecticut net income tax, under which the amount taxable was such proportion of the entire net income as the value of real and tangible personal property bore to the value of such property everywhere. The taxpayer's manufacturing was done in Connecticut, where 47 percent of the value of its property was located. The taxpayer contended that, since only about 3 percent of its profits were received from sales and other transactions in Connecticut, it was improper to base the tax upon 47 percent of its entire net income. It argued (as the District does here) that income was "attributable only to the processes of sale", and that "it is of no consequence where the factory is located".[24] This Court rejected that theory, declaring that "The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other States" (254 U.S. at 120). In the absence of

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[23] Earlier, in *United States Glue Co.* v. *Town of Oak Creek*, 247 U.S. 321, the Court had sustained an apportioned net income tax, rejecting a contention that interstate commerce was unconstitutionally burdened by including in the tax base income from a domestic manufacturer's sales into other states. The validity of the apportionment formula (based on the two factors of property and gross business) was not placed in issue. It is of interest in the present connection, however, that the state court (161 Wis. 211, 218, 153 N.W. 241, 244), in rejecting the argument that the income from out-of-state sales had its situs elsewhere, declared: "The manufacture, the management, and the conduct of the business at the home office are the controlling features in the process of disposing of the articles produced at the factory, and constitute the source out of which the income issues, and give it a situs within this state under the income tax law."

[24] Brief and Argument on Behalf of the Plaintiff in Error, pp. 33-34, 36, 45.

other evidence that the single-factor property formula did not fairly measure the income attributable to activities in the taxing state, the Court concluded that the state had "adopted a method of apportionment which, for all that appears in this record, *reached, and was meant to reach, only the profits earned within the State*" (*id.* at 121; emphasis added).[25]

The other side of the coin was presented in *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U.S. 271, which involved a New York franchise tax measured by the net income of a corporation which manufactured abroad and made sales in New York and elsewhere. That tax, like the one in *Underwood*, was based on income apportioned in the ratio of property values. This Court sustained the tax, declaring that, since the taxpayer's "profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places—the process of manufacturing resulting in no profits until it ends in sales—the State was justified in attributing to New York *a just proportion* of the profits earned by the Company from such unitary business" (266 U.S. at 282; emphasis added). Significantly, the tax was not based (as in the present case) upon the entire profit from sales into New York, but upon a property ratio which, in the absence of evidence to the contrary, was accepted as a fair indication of the location of the activities which produced the income.

A single-factor property formula came before this Court for the third time in *Hans Rees' Sons, Inc.* v.

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[25] The Court also declared (254 U.S. at 120) that the criteria for a valid apportionment were the same whether the tax was a net income tax or a franchise tax measured by net income.

North Carolina, 283 U.S. 123, which involved a North Carolina tax on the net income of a corporation which manufactured in North Carolina and sold in other states. The property ratio resulted in taxing approximately 80 percent of the net income in North Carolina. The taxpayer offered accounting evidence tending to show that only 17 percent (or, by an alternative analysis, 21.7 percent) of the net income was attributable to the activities carried on in the state. The state courts struck that evidence as immaterial, under their interpretation of *Underwood* and *Bass, supra.* This Court, however, declared that "These decisions are not authority for the conclusion that where a corporation manufactures in one State and sells in another, the net profits of the entire transaction, as a unitary enterprise, may be attributed, regardless of evidence, to either State. In the *Underwood* case, it was not decided that the entire profits of the total business were to be allocated to Connecticut because that was the place of manufacture, or, in the *Bass* case, that the entire profits were to be allocated to New York because that was the place where sales were made" (283 U.S. at 132-133). The defect of proof in both cases was said to be a failure to show that the method of apportionment charged the taxpayer with income "not reasonably attributable to *the processes conducted* within the borders of that State" (*id.* at 133; emphasis added). In a unitary business of manufacturing and selling, said the Court, "all the factors in that enterprise are essential to the realization of profits" (*id.* at 133).

Based upon the tendered evidence (the nature of which is more fully discussed at pp. 38-45, *infra*), this Court found that the single-factor property formula, in the circumstances of the *Rees* case, "operated un-

reasonably and arbitrarily, in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted by the appellant in that State" (283 U.S. at 135). The tax was held, therefore, to be beyond the state's authority.

The North Carolina law again came before this Court in *Kent-Coffey Mfg. Co.* v. *Maxwell*, 291 U.S. 642, involving a North Carolina manufacturer with over 99 percent of its property in the state and over 99 percent of its sales elsewhere. The state court found that the manufacturer had had full opportunity to present evidence showing that its net profits arose from business conducted elsewhere and yet had completely failed to introduce any evidence whatever at either of two hearings.[26] The complete record, in fact, consisted of a petition, a tax return, a letter from the state commissioner of revenue, a check and several computations. Under these circumstances, the state court declined to hold that attribution of some 99 percent of the profit to the manufacturing state was unreasonable,[27] and this Court, in affirming *per curiam*,

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[26] *North Carolina ex rel. Maxwell* v. *Kent-Coffey Mfg. Co.*, 204 N.C. 365, 374-375, 168 S.E. 397, 402. The manufacturer admitted that this was the holding of the state court. Brief and Argument for Appellant, p. 30.

[27] The state court said, "The bare fact of sale produces no income. It is merely the act by which the income is captured; the capital, the organization, or efforts which produce the sale, are the things to be considered in ascertaining the amount of income to be credited to the sale. Certainly, in a unitary business, we must look further back than to the sale itself or the activities which actually produce it. The tangible property element of capital outlay is cared for in the tangible property ratio set up by the statute. If there is anything beyond that of sufficient magnitude to affect the constitutionality of the application of this rule, it must be shown in the evidence: the burden resting upon the taxpayer to do so" (204 N.C. at 370, 168 S.E. at 400).

simply held the case to be controlled by *Underwood* rather than by *Rees*.

The next case, *Norfolk & Western Ry.* v. *North Carolina*, 297 U.S. 682, involved the apportionment of a railroad's net income on the basis of a mileage ratio. Reiterating that, as in *Rees*, it might be shown in a particular case that such a ratio worked an unfair result, since unusual handicaps might be found to make the net revenue from mileage within the state substantially lower than the average, this Court held that the proof offered was insufficient for the purpose.[28]

In *Butler Bros.* v. *McColgan*, 315 U.S. 501, this Court considered for the first time a three-factor formula (apportioning income on the basis of the average of the ratios of property, payroll and sales), comparable to—although not identical with—the formula adopted by the Tax Court herein and the formulae now used by a substantial majority of the states. This Court upheld a California franchise tax measured by net income so apportioned, despite the taxpayer's claim that separate accounting (with central buying costs and other overhead allocated among the branches) showed a loss on the California business. The Court held that the volume of business contributed by the California branch was a factor in the over-all profits of the business, and that the formula of property, payroll and sales served "to reflect 'the relative contribution of *the activities in the various states* to

[28] The taxpayer showed that its expenses per mile in the state were far above average, but failed to show that its gross revenues per mile were not also greater. Hence there was insufficient evidence on which to base "a more accurate apportionment" of *net* income from activities within the state.

the production of the total unitary income' " (315 U.S. at 509; emphasis added).

In *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, the Court upheld the application of Minnesota and Georgia net income taxes to corporations engaging only in minimal activities (solicitation of orders, etc.) through local offices in such states. The issue decided was whether such activities sufficed to give the states *jurisdiction* to impose any income tax at all. It was undisputed that, if jurisdiction to tax existed, the three-factor formula used by each state was reasonable (*id.* at 452). Pointing out that the taxes were "levied only on that portion of the taxpayer's net income which *arises from its activities* within the taxing state" (*id.* at 464; emphasis added), the Court held that the Due Process Clause would not invalidate the taxes involved.

The Effect of the District's "Formula"

The formula involved in the present case, apportioning income in the ratio which sales to District customers bear to sales everywhere, is like none of those heretofore considered by this Court. As fully demonstrated under Point I of this brief, the single-factor sales formula does not *apportion* income at all, but merely *identifies* the segment of income produced by the series of manufacturing, selling and other activities, almost entirely carried on outside the District, which culminate in sales to District customers; and it taxes such segment of income *in its entirety*. In holding the assessments invalid, the Tax Court found *as a fact*, on a full record, that the petitioner's net income which was subjected to tax was earned by a series of transactions which took place outside the

District (Finding No. 5, R. 495-496; App. A, p. 3a, *infra*):

> "The segment of petitioner's business which was conducted both within and without the District of Columbia consisted of the manufacture of a certain number of automobiles and kindred products without the District and the sale thereof to customers within the District. The net income from this segment of petitioner's business was earned by a series of transactions beginning with the manufacture of products in several states and ending with the sale to customers in the District. While the net income was not realized until sale, it was earned in part by manufacture of the products sold, including in addition to actual manufacture, procurement of material, financing, use of property and administration."

Then it continued (Finding No. 6, R. 496; App. A, p. 3a, *infra*):

> "The method used by the assessing authority of the District attributed to the District 100 per centum of the net income derived by the petitioner from that segment of its business which consisted of the manufacture without, and sale of the products within the District. The percentage thus determined was out of all reasonable proportion to the trade or business carried on or engaged in by petitioner within the District."

Thus the Tax Court has set up a perfect syllogism:

(a) the net income arising from business culminating in sales to District customers was in part earned outside the District;

(b) the District formula taxed 100 percent of such net income;

(c) that percentage was grossly disproportionate to the activities in the District.

The Court of Appeals does not deny the factual correctness of premises (a) and (b), findings which were not only based upon ample evidence, including the testimony of the District's own witnesses, but which, as to (b), are demonstrable from the structure of the regulation (as applied) itself.[39] Instead, it dismissed the finding as "irrelevant" (R. 517). The Court reasoned that because the Tax Court made the legal error of thinking that only the segment income was to be apportioned rather than the entire net income from all operations, whether or not ending in sales to District customers, premise (b) above was vitiated, and hence the conclusion (c) must fall. The *non sequitur* is obvious. Actually, both petitioner and the Tax Court recognized from the beginning that *total* net income was to be apportioned, as was in fact done by the Tax Court's decisions (R. 459-461), and the Court of Appeals incorrectly stated petitioner's interpretation of the statute (*supra*, pp. 20-23). Aside from that, however, it is clear that the syllogism moves from fact to fact, without the application of any view of the law, right or wrong, and that the conclusion (c) is inescapable. It is a finding of fact which should have been respected as such by the Court of Appeals.

The statement of the Court of Appeals that the finding (that the assessments reached 100 percent of the segment income) is "irrelevant" (R. 517) flies squarely in the face of this Court's decision in *Hans Rees' Sons, Inc.* v. *North Carolina, supra*, 283 U.S. at 135, where just such findings as the Tax Court made here formed the basis for invalidating an apportionment formula as applied to the taxpayer before the Court.

[39] See discussion of the testimony, *supra*, pp. 15-18, *infra*, pp. 41-43, 52.

The majority below sought to distinguish *Hans Rees' Sons* on the ground that the proof "must be much more detailed and specific than that adduced here", and that petitioner "did not undertake to show that the District of Columbia operations accounted for a specific percentage of General Motors' total income, which percentage could, as in *Hans Rees' Sons*, be compared with that taxed under the single-factor formula. . . . Nowhere in the record do there appear specific percentages of the kind accepted by the Supreme Court in *Hans Rees' Sons*" (R. 518-522).[30]

The Evidence of Unreasonableness

It is universally recognized that no administratively feasible method of assigning income to its source achieves ultimate precision. Noting the absence of such precision in the proof offered in *Hans Rees' Sons* (where alternative analyses ascribed from 17 to 21.7 percent of income to the taxing jurisdiction), this Court declared that it was *not necessary* "to deter-

[30] Petitioner had been forewarned by the Court of Appeals decision in *Smoot Sand & Gravel Co.* v. *District of Columbia*, 104 U.S. App. D.C. 292, 261 F.2d 758, *cert. denied*, 359 U.S. 968, in which the taxpayer sought protection under the doctrine of *Hans Rees' Sons*. Smoot showed that all its "manufacturing" operations took place in Virginia, and offered measures by which to determine what part of its income was attributable thereto. The court thought the measures were irrelevant because it had not been shown in principle that manufacturing contributed anything at all to the production of income. Apparently, Smoot had not thought it necessary to prove that point, in view of the pronouncements of this Court that income is the product of capital and labor, a proposition which seems self-evident. However, since it was not self-evident to the Court of Appeals, we undertook to, and did, prove it by expert testimony, and then went on to prove similarly the best ways of measuring those contributions and attributing them geographically. The precise figures were stipulated, and are summarized in App. C., p. 49a, *infra*.

mine as a matter of fact the precise part of the income which should be regarded as attributable to the business conducted in North Carolina" in order to determine that the amount taxed was excessive (283 U.S. at 134-135). In the instant case, on the other hand, the Court of Appeals uses the impossibility of theoretical precision to excuse the District's so-called "formula" while at the same time using it to destroy petitioner's evidence and the Tax Court's findings and computations.

The fact is that the proof in this case, as compared to that in *Hans Rees' Sons,* is "much more detailed and specific" "to show that the District of Columbia operations accounted for a specific percentage of General Motors' total income, which percentage could . . . be compared with that taxed under the single-factor formula." The record contains and fully supports "specific percentages" far superior in accuracy to those "accepted by the Supreme Court in *Hans Rees' Sons.*" (Quotations from the court below, R. 519, 521.)

In *Hans Rees' Sons,* the evidence by which the reasonableness of the apportionment was tested was an application of separate accounting, which was feasible in the case of a simple business dealing in a single fungible product (leather).[31] Even if it were

[31] In *Hans Rees' Sons,* the taxpayer showed (a) what its activities were, (b) market prices at various stages of production of goods of the kind in which it dealt, and (c) by accounting testimony, the approximate net income derived from each of its business activities considered separately. The taxpayer tendered evidence purporting to show that no more than 17% of its net income was produced by manufacturing and tanning of leather in the taxing state. This Court's decision does not reveal the method by which the taxpayer's witness arrived at that percentage, but the briefs and record in this Court indicate that the taxpayer attributed the

desirable, it is not feasible for a unitary manufacturing business, lacking established market prices at each level of production—whether that business be large or small—to use the technique employed by Hans Rees' Sons' accountants. Furthermore, in petitioner's case, all the elements of production were located without the District and the District activities were only incidental to those elements, so that separate accounting, if feasible, would actually attribute all or most of petitioner's income to transactions outside the District.

Separate accounting, however, is not the only nor even the best method of assigning income to source. In fact, in *Butler Bros.* v. *McColgan, supra,* 315 U.S. at 506-9, it was rejected as an *impermissible* means of testing the validity of an apportionment formula. The objective is to measure relative contributions of various elements, at various locations, to total income. The bases and measures offered by petitioner are sound, accurate, and free from the infirmities (failure to consider the effect of one operation upon the whole) pointed out in *Butler Bros.* To hold, as the court below did, that no evidence other than the separate accounting in *Hans Rees' Sons* can be used to test a formula would nullify the constitutional protection against arbitrary and excessive apportionment in the

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entire profit from wholesale sales to the manufacturing process, and determined the profit on retail sales outside the manufacturing state by comparing the price received at retail (less the cost of processing at the retail level) with the average wholesale market price of the product. The taxpayer's accountant also used an alternative method, under which the manufacturing profit was determined by comparing the actual cost of leather manufactured by the taxpayer with what it could have been bought for on the open market. It was the latter method which produced the 17% figure referred to by the court below (R. 520).

case of all but the simplest businesses in our complex society.

Petitioner presented testimony of acknowledged experts in economic analysis.[32] Their testimony established that the petitioner's net income is derived from and attributable to the totality of its activities and efforts as an integrated manufacturing business—*i.e.*, from the application of the factors of production, land, capital, labor and enterprise (R. 24, 29, 40, 58-59, 67, 75, 95, 107-108, 113, 211-213, 218-219). While selling *activities*—along with manufacturing, administrative and other activities—unquestionably contribute to the production of income, these expert witnesses were firmly of the opinion that no income is created by the sale as such, which merely realizes or severs the in-

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[32] The witnesses were:

William A. Paton, who taught economics and accounting at the University of Michigan for nearly 50 years and was the author and editor of numerous books in those fields, including the standard reference book on accounting. (R. 8-11, 35-37.)

Weldon Powell, a practicing certified public accountant (partner in one of the leading national accounting firms), who was chairman of the Accounting Principles Board of the American Institute of Certified Public Accountants, with responsibilities for guiding the profession in such matters as the determination of income from business transactions. He was also trained in economics, and regularly dealt professionally in the classification, analysis, interpretation and reporting of economic data. (R. 62-66, 72-73.)

Paul Studenski, who for some 40 years had been an economist, most of that time teaching economics, public finance, public financial administration and national income analysis on a graduate level at New York University. He had served as consultant or research director for several federal and state agencies, and had written numerous books and articles, including studies of the apportionment of income for state tax purposes. (R. 88-90.)

Walter Morton, who had taught economics at the University of Wisconsin and other institutions for over 35 years and had been a consultant to various industries. (R. 209-210.)

come created by the activities referred to (R. 40-45, 59-60, 84, 94-98, 104, 212, 219, 223, 246-248).[33]

Having determined that net income is attributable to the factors of production, the next step is to achieve a rational geographical attribution of such income. The basic principle, of course, is that geographically the income is earned where the factors of production are employed to earn it. (R. 27-28, 44-45, 92-93, 117, 218, 226-227.) Since not all the factors are employed in the same proportions in all areas, some measures are necessary. The best available measures are the costs of the factors of production employed in each place. (R. 24-30, 43-44, 66-68, 93-94, 114-117, 225-227, 237.) Thus, the ideal method of making a geographical attribution of income would be to locate each dollar of cost at the place where the capital or labor it represents is employed and attribute to that place a proportionate part of the income. (R. 39-43, 76, 92-93, 225.) Since detailed cost accounting is not feasible in tax administration, a close approximation of the proper attribution of income is achieved by taking the amount of property employed as representative of land and capital costs, and payrolls as representa-

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[33] To similar effect, see the quotation from *State ex rel. Maxwell* v. *Kent-Coffey Mfg. Co.*, 204 N.C. 365, 168 S.E. 397, *aff'd per curiam sub nom. Kent-Coffey Mfg. Co.* v. *Maxwell*, 291 U.S. 642, set out in footnote 27 on page 33, *supra;* and the quotation from this Court's decision in *Hans Rees' Sons, Inc.* v. *North Carolina, supra*, 283 U.S. at 132-3, set out in the text at p. 32, *supra*. The witnesses acknowledged that, for practical reasons, accountants do not ordinarily recognize or record income until it is realized or severed by sale, and the tax laws do not ordinarily tax it until that time; but they stated that such facts do not detract from the fact that the antecedent activities, not the sale itself, earned or produced the income (R. 47-48, 54-55, 59, 69, 83, 217, 246.)

tive of other costs of production.[34] (R. 38-39, 76, 93-94, 226-229.)

The stipulated facts established that the factors of production, in petitioner's case, even with respect to products sold to customers located in the District, were employed almost exclusively in jurisdictions other than the District; and that respondent's allocation of petitioner's income based solely on destination of sales attributed to the District many times the amount of income properly attributable to the factors of production applied therein. (R. 385-7; tabulated in App. C, p. 49a, *infra*.) In 1957, only .0218 percent of petitioner's property (including rented property) and .0477 percent of petitioner's payroll, or an average of .0348 percent, were located in the District. The amount taxed in the District was .3930 percent of petitioner's total net income, or over eleven times the amount actually produced by application of the factors of production in the District. In 1958, only .0207 percent of petitioner's owned and rented property and .0524 percent of its payroll, an average of .0366 percent, were located in the District. The amount taxed in the District was .4144 percent of petitioner's total net income, or again over eleven times the amount actually produced or earned by activities in the District.

The Court of Appeals says (R. 524): "Aside from the economic arguments that the income from these

[34] Property is not itself a cost, but its location is an accurate indication of where the costs relating to property are incurred. No distortion results from using the amount of property rather than the related costs, since the figures are reduced to a percentage (R. 231-232). The fourth factor of production, enterprise, is not separately taken into account, since it inheres in the use and direction of property and payroll (R. 241-243).

sales were (sic) attributable to operations in jurisdictions outside the District, no showing was made that the relatively minor portions of sales were not reasonably attributable to the concededly relatively minor scope of operations in the District." The question is not to what activities the *sales* are attributable, but to what activities the *net income* is attributable. Furthermore, the court seems, because of the small size of the District figures (as compared to the aggregate of petitioner's activities and income everywhere) to disregard disparities within the District as *de minimis*. When the above figures are compared with *each other*, it is apparent that the amounts taxed were not "relatively minor" but were over eleven times the amount of income produced by District activities by any acceptable quantitative measure thereof.

The excessive taxation is seen to be even more significant when it is considered that petitioner's activities connected with the great bulk of such sales were carried on by personnel traveling into the District, using only nominal amounts of property (principally their automobiles), and drawing compensation for time spent in the District in the amounts of $65,099 in 1957 and $75,694 in 1958 (R. 387). The net income derived from all business culminating in sales to District customers was $5,156,525 in 1957 and $2,707,677 in 1958 (R. 372-375; App. C, p. 49a, *infra*). The Court of Appeals would attribute to services which cost petitioner $65,099 in 1957 a net income of $5,156,525—*79 times* as great; but petitioner's total net income (before taxes) of $1,312,092,839 was *less than half* total payroll of $2,662,072,037 (R. 372, 386-387, App. C, p. 49a, *infra*). (The figures for 1958 are less dramatic but of the same order.) In other words, District busi-

ness is 158 times as profitable as the average of petitioner's entire business! This remarkable conclusion is reached notwithstanding the testimony of the District's own witnesses, and the assumption made by the District in its calculations, that the income related to every dollar of sales is the same as to every other dollar of sales (R. 172).

Based upon the stipulated facts, which were presented to the experts in the form of a hypothetical question, each of them testified that, in his opinion, the single-factor sales ratio employed by the respondent did not fairly apportion a part of petitioner's net income to the business done in the District, but rather assigned an unreasonable and excessive amount of income to such business. (R. 30-32, 37-39, 71, 75, 91-92, 95, 211-212.)

On the basis of that testimony and the stipulated facts, the Tax Court made the finding heretofore quoted (p. 36) that the percentage of income taxed under the District's single-factor formula was "out of all reasonable proportion to the trade or business carried on or engaged in by petitioner within the District".

Single-Factor Formulae

The Court of Appeals, stating that "We need not demonstrate that the particular fact found is untrue if it is irrelevant" (R. 517), declared that it is well settled that "a single-factor formula is not inherently arbitrary or unreasonable" (R. 518). Of the cases cited from this Court, only one bears a superficial resemblance to this case, in that it involved a single factor of sales: *Ford Motor Company* v. *Beauchamp*, 308 U.S. 331. Unlike the others, discussed below, *Ford*

concerned a capital stock tax, and had nothing to do with the apportionment of income. The facts were widely different from the instant case. For example, a large assembly plant was located in the taxing state, and the gross receipts used to measure the taxable capital were entirely from intrastate transactions. 308 U.S. at 333. The Fifth Circuit Court of Appeals, *sub nom. Ford Motor Co.* v. *Clark,* 100 F.2d 515, 518, distinguished *Hans Rees' Sons, Inc.* v. *North Carolina, supra,* 283 U.S. 123, on the basis that rules for the taxation of income "are irrelevant" to the taxation of capital; and this Court did not mention *Hans Rees' Sons* at all. The *Ford* case is, therefore, irrelevant here.

The other two cases cited by the Court of Appeals as sustaining a single-factor formula involved the use of a property factor. *Underwood Typewriter Co.* v. *Chamberlain, supra,* 254 U.S. 113; *Bass, Ratcliff & Gretton, Ltd., supra,* 266 U.S. 271. An apportionment formula based on only one of the several factors of production, such as property, and ignoring the rest, may achieve a permissible rough approximation in a particular case if the disregarded elements exist in the jurisdiction in proportions not too far different from the factor which is considered. Such a formula will, however, be invalidated as "arbitrary and unreasonable" if in a particular case it produces a seriously unjust result.[35] *Hans Rees' Sons, Inc.* v. *North*

[35] It is worth noting that the single-factor formulae involved in *Ford Motor* (intrastate sales from local stocks), *Bass* (property) and *Underwood* (property), upon which the Court of Appeals relies, would, if applied in this case, reduce petitioner's liability for District tax to near zero. So would the two-factor formula accepted in *International Harvester Co.* v. *Evatt,* 329 U.S. 416 (property and sales from local stocks), and the three-factor for-

Carolina, supra. In *Underwood,* in the absence of evidence to the contrary (such as was presented in *Rees* and in the present case), the Court sustained the single-factor property factor as one which, "for all that appears in this record, reached, and was meant to reach, only the profits *earned* within this State" (254 U.S. at 121; emphasis added).

In contrast, the single-factor *sales* formula reaches, and is designed to reach, the *entire* net income connected with every sale into the District, including income earned by the application of capital and services in other jurisdictions. The so-called "formula" does not apportion income at all, but simply identifies "the net profits from the entire transaction", a step which is merely preliminary to apportioning such profits, pp. 20-23, *supra.* Such a formula is plainly "intrinsically arbitrary" and not "fair on its face", since only by the merest chance could it possibly produce an apportionment approximating a fair distribution of income between the District and the states in which manufacturing and other income producing activities are carried on. In addition, we have proved by cogent evidence that the formula is "unreasonable and arbitrary" when applied to the facts of this case,

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mulae accepted in the Minnesota part of *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450; *Spector Motor Service, Inc.* v. *O'Connor,* 340 U.S. 602 (including sales through local offices); and *Butler Bros.* v. *McColgan,* 315 U.S. 501 (including sales solicited in-state). The three-factor formulae in the Georgia part of *Northwestern States* and in *Armco Steel Corp.* v. *Michigan,* 359 Mich. 430, 102 N.W. 2d 552, *appeal dismissed,* 364 U.S. 337 (including sales assigned to location of customer) would produce District tax liability about equal to that found by the Tax Court. See the tabulation of the application of various approved formulae to the facts of this case (using 1957 figures) in App. F, p. 57a, *infra.* No formula previously approved would begin to approach the amount assessed by the District in this case (R. 373-374).

and taxes profits in "no just sense attributable to transactions" within the District. *Hans Rees' Sons, Inc.* v. *North Carolina, supra,* 283 U.S. at 133, 134.

In sustaining the tax in the face of the record and the findings, and in the face of this Court's often-repeated statement (in accord with the view of petitioner's witnesses) that "The profits of the corporation were largely earned by a series of transactions beginning with manufacture . . . and ending with sale", the court below has placed itself in direct conflict with this Court.[36] In *Hans Rees' Sons, Inc.* v. *North Carolina, supra,* 283 U.S. at 132, this Court declared that the *Underwood* and *Bass* decisions "are not authority for the conclusion that where a corporation manufactures in one State and sells in another, the *net profits of the entire transaction,* as a unitary enterprise, may be attributed, regardless of evidence, to either State" (emphasis added). The Court of Appeals recognized the agreement in theory between this Court and petitioner's experts, but declared that "The theory proved the case in *Underwood* no better than it does here." This shows how badly the Court of Appeals missed the point of *Underwood,* which was that, since the net income was attributable to activities both in Connecticut and in other states, an apportionment of some of the income to Connecticut was not improper. Here the net income from District sales is attributable to activities both in the District and in other states (almost entirely in other states), but the Court of Appeals would tax the *entire* income in the District. *Un-*

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[36] *Underwood Typewriter Co.* v. *Chamberlain, supra,* 254 U.S. at 120; *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission, supra,* 266 U.S. at 282; *Hans Rees' Sons, Inc.* v. *North Carolina, supra,* 283 U.S. at 129-130.

derwood, far from supporting the court's conclusion, is strong authority to the contrary.

B. The Assessments Unconstitutionally Impose upon Interstate Commerce Multiple Tax Burdens to Which Intrastate Commerce Is Not Subject.

Constitutional Restraints

Since the power to regulate commerce is one affirmatively conferred upon Congress by the Constitution, Congress itself in legislating for the District is not subject, as are the states, to restraint on the imposition of burdens upon interstate commerce. *Neild* v. *District of Columbia,* 71 U.S. App. D.C. 306, 309-12, 110 F.2d 246, 249-52. What Congress might do itself in that regard, however, cannot necessarily be delegated to local officers. In *Stoutenburgh* v. *Hennick,* 129 U.S. 141, 148, the business of selling goods in the District, on behalf of those outside the District, was held to be interstate commerce; and this Court further held that the exercise of the power to regulate such commerce "cannot be treated as a mere matter of local concern, and committed to those immediately interested in the affairs of a particular locality". Therefore, while the Court refrained from passing on whether Congress itself could have imposed the burden in question (a matter later set at rest in the *Neild* case, *supra*), it squarely held that Congress could not delegate any such power to the local governing body of the District. The *Stoutenburgh* decision was cited with approval on this point in *District of Columbia* v. *John R. Thompson Co.,* 346 U.S. 100, 107.

It is not the law as passed by Congress but the formula adopted by the District Commissioners under delegated power (and as applied by the Finance Offi-

cer) that causes the burden on interstate commerce complained of in this case. As the court below recognized (R. 525-526), nothing in the 1947 Income and Franchise Tax Act required (even assuming it permitted) the adoption of the single-factor sales formula.[37] Therefore, the decisions of this Court forbidding the exercise of local (state) power to impose burdens on interstate commerce are pertinent to this case.

This case is a good illustration of the freedom of *Congress* from interstate commerce restraints: The tax is a *franchise* tax, a tax for the privilege of engaging in commerce, and not, as in *Northwestern States* v. *Minnesota, supra,* 350 U.S. 450, a net income tax. A franchise tax cannot be imposed by a state upon purely interstate commerce. *Spector Motor Service, Inc.* v. *O'Connor,* 340 U.S. 602. However, since Congress itself enacted the franchise tax, the *nature* of the tax is not subject to Commerce Clause attack. On the other hand, the *measure* of the tax was prescribed not by Congress but by the District Commissioners, who do not enjoy and cannot have delegated to them the freedom of Congress with respect to interstate commerce.

Many of the decisions which have struck down unapportioned or malapportioned taxes have relied more or less interchangeably on the Due Process Clause and the Commerce Clause. An unreasonable and arbitrary apportionment which deprives the taxpayer of property without due process of law would also unduly burden interstate commerce. In one important

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[37] In contrast, in *Neild* v. *District of Columbia, supra,* it was Congress itself that had imposed the unapportioned "business privilege tax," and local action under delegated powers was not involved.

respect, however, reliance on the Commerce Clause does add something to the due process argument already made.

The Commerce Clause, which was designed to create a "federal free trade unit" or national common market (see *H. P. Hood & Sons, Inc.* v. *Du Mond*, 336 U.S. 525, 538-9), forbids double taxation which has the effect of discriminating against interstate commerce by subjecting it to "cumulative burdens not imposed on local concerns". *Western Live Stock* v. *Bureau of Revenue*, 303 U.S. 250, 255-6; *Michigan-Wisconsin Pipe Line Co.* v. *Calvert*, 347 U.S. 157, 170; *J. D. Adams Mfg. Co.* v. *Storen*, 304 U.S. 307, 311-2; *Gwin, White & Prince, Inc.* v. *Henneford*, 305 U.S. 434, 439. That principle was reiterated by this Court in *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 458, 462-3, and in *General Motors Corp.* v. *Washington*, 377 U.S. 436, 440.

Evidence of Double Taxation

There should have been no doubt of the *fact* of double taxation. It was stipulated that none of the products sold to District customers were manufactured or assembled in the District. With respect to vehicles (constituting 95-97 percent of the taxed sales, R. 377-380), it was proved (R. 3-4) and found (R. 437; App. A, pp. 2a-3a, *infra*) that such manufacture and assembly occurred very largely at plants in Michigan, Delaware and Maryland.[38] It was proved by the expert testimony, heretofore analyzed, and the Tax

[38] With respect to the other products involved, which were relatively very minor in amount, the record is incomplete concerning the location of the plants but is clear that they are not in any case in the District.

Court found (Finding 5, R. 495-496; App. A, p. 3a, *infra*), that the net income from the sale of those products was attributable largely to such manufacturing activity, as well as to selling activity emanating from zone offices in Maryland (R. 262, 268-270, 294) and elsewhere. It was proved (R. 13-19) and found (Finding 3, R. 437-8, 495; App. A, p. 2a, *infra*) that a portion of the net income from each sale from those three states into the District, reflecting the capital and labor applied in those states toward the earning of such income, was taxed by those states, under three-factor formulae based upon the factors of property, payroll and sales, equally weighted.[39] The validity of the taxes in those other states is beyond dispute, for they were based on an apportionment of income which gave proper weight to the factors by which the income was produced. *Armco Steel Co.* v. *Michigan*, 359 Mich. 430, 102 N.W.2d 552, *appeal dismissed*, 364 U.S. 337 (sustaining the Michigan tax law); *Butler Bros.* v. *McColgan*, 315 U.S. 497; *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450. It was also proved (R. 211, 214), was admitted by the District's witnesses (R. 164-167, 183-185, 206-207), and was found by the Tax Court (Finding 6, R. 496; App. A, p. 3a, *infra*), that the District's method resulted in taxing, not a part, but the entire net income from all activities culminating in each such sale from those other states to customers in the District.

On the basis of that record, the Tax Court found, in addition to all the stipulated details, that: the products sold to District customers were manufactured largely in Michigan, Maryland and Delaware; peti-

[39] The pertinent provisions of the statutes are set out in Appendix B, pp. 38a-48a, *infra*.

tioner paid income taxes in specified amounts to these states "in accordance with the statutes of the respective states"; "A portion of the net income of petitioner derived from the segment of the petitioner's business consisting of the manufacture of products without, and sale within the District of Columbia was taxed by the above mentioned states, pursuant to apportionment formulae (with factors of property, payroll and sales), as provided by their laws"; and "The method used by the assessing authority of the District attributed to the District 100 per centum of the net income derived by the petitioner from that segment of its business which consisted of the manufacture without, and the sale of products within the District." (R. 437-8, 495; App. A, *infra*, pp. 1a-2a.)

Without quoting or directly referring to those findings, the Court of Appeals declared that petitioner had "failed to" "show by specific evidence that 'double taxation' would result from the application of the District formula" (R. 523). The court did not dispute the underlying facts set out above, but it quibbled about the possibility that the state laws involved might define the various factors differently, or might use different accounting procedures, or allow different deductions from gross income (R. 524-525). The Tax Court, however, had the tax laws of the three states before it (R. 13, 15, 18), and was entitled to and did take judicial notice thereof. It also had before it the tax returns filed by petitioner in the three states (R. 14-19; Exhibits 9, 12, 15, 18 and 19, not printed), which showed on their face how net income was computed and how two-thirds of the income from products manufactured in those states was there taxed. It also had before it cancelled checks and receipts

showing payment of the taxes so computed (R. 14-19). It had before it the District tax returns showing how net income was computed (Exhibits 1 and 2, in evidence at Tr. 25, not printed), and stipulated figures from such returns and from the assessments which on their face show that 100 percent of income from business culminating in sales to District customers was taxed in the District (R. 373-374).

That evidence was not before the Court of Appeals for consideration, since the District had not challenged the sufficiency of the evidence to support the Tax Court's finding, and had not printed such evidence in its Joint Appendix, as it would have had to do, under Rule 16(a) of the General Rules of the Court of Appeals for the District of Columbia Circuit, in order to challenge the findings. It was, therefore, highly improper for the court below, by speculative criticism of evidence not before it, to reject the fact finding of the Tax Court, which unequivocally determined that *a portion of the same income* (i.e., income from District sales of products manufactured elsewhere) had in fact been taxed in the other states, pursuant to three-factor formulae based on property, payroll and sales.

The Duplication Was Real and Not Hypothetical

Ignoring the evidence, the Court of Appeals stated that "the company has produced only a hypothetical situation to prove its case" (R. 523). Simplified hypothetical figures were indeed used in petitioner's brief to illustrate *how* the double taxation resulted necessarily from the District's improper "formula", but the *fact* of double taxation found by the Tax Court was demonstrated by evidence (as outlined above), not

by hypothesis.[40] The "hypothetical situation", which the Court of Appeals (R. 523-524) quotes from petitioner's brief in that court, was as follows:

> "Assume that Chevrolet has a net income of $3,000,000 derived from the manufacture and sale of automobiles sold to customers located in the District; that three-fourths of the manufacturing activity takes place in Michigan and one-fourth (including the activities of the zone or 'sales' office) takes place in Maryland. Michigan would tax 50% of the income (one-third of 75% property, 75% payroll, 0% sales), Maryland would tax 16-2/3% (one-third of 25% property, 25% payroll, 0% sales); and the District would tax 100% (sales alone). Chevrolet is taxed by the three states combined on 166-2/3% of its total income."

This example effectively illustrates that the double taxation was no minor overlap, but a substantial duplication. The example was based on evidence, showing that nearly all of petitioner's relevant income-producing facilities and activities were in other states which, using three-factor formulae like that in the example, attributed almost two-thirds of the income (from sales to District customers, as well as all other sales) to capital and labor employed in those states and one-third to the sale. The illustrative figures differ, of course, from those in evidence; but the substitution of actual figures, or altering the proportions between Michigan and Maryland, or substituting Maryland or Delaware as the state of manufacture, would not affect the demonstration that, when the District taxed

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[40] A comparable "simplified example" was found "commendable" by this Court in clarifying the issues in *United States* v. *Consolidated Edison Co.*, 366 U.S. 380, 382. Our example was used for that purpose, and was based on the evidence, not offered as a substitute for evidence.

100 percent of the income from sales to District customers, approximately two-thirds of the income from such sales was inevitably taxed twice.[41]

The Court of Appeals relied upon language in *Northwestern States Portland Cement Co.* v. *Minnesota, supra,* 358 U.S. at 462-463, to the effect that the taxpayer must demonstrate burdens on interstate commerce rather than force the Court to deal in abstractions (R. 525). But the record in *Northwestern States* not only distinguishes that case from this one but helps to demonstrate the difference between an "abstraction", or impermissible hypothetical, and the valid example of double taxation set forth by petitioner.

In the *Northwestern States* companion cases, the taxpayers' real objection was not that the states' three-factor formulae were unfair but rather that the taxpayers had insufficient connections with the states to allow them to be taxed on their purely interstate business.[42] During the course of its argument, however, Northwestern States did say that "The statute involved here is so designed that it *could easily lead* to

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[41] To the extent that the property and payroll were present in the jurisdiction where the sale occurred, the proportions stated would vary. But those factors were minimal here, as the stipulated facts summarized in Appendix C, *infra*, p. 49a, demonstrate. If, as suggested by the Court of Appeals, the other States used the *origin* of the sale, rather than its destination, as the standard for determining the sales factor, the duplication would be more nearly 100% than 66-2/3%, since it was stipulated that, except for the relatively minor (R. 377-80) sales of United Motors Service Division during part of the taxable period (R. 294), almost all the sales to District customers originated elsewhere, principally in the three States mentioned (R. 260-300).

[42] See 358 U.S. at 452.

multiple taxation of interstate commerce, a burden not imposed upon purely local or intrastate commerce" (*Northwestern States Portland Cement Co.* v. *Minnesota,* Brief for the Appellant, p. 13; emphasis added). To support this assertion, Northwestern States asked the Court to assume that instead of being an Iowa corporation doing business in Minnesota, it was a Minnesota corporation doing business in Iowa. It then applied the three-factor formula to its assets, concluded that 99.424 percent of its income would be taxed by Minnesota, and reasoned that "This state of facts clearly demonstrates that a net income tax can be a real burden on interstate commerce" (*id.* at 29; emphasis added).

As pointed out by Minnesota in its reply, however, Northwestern States in this hypothetical not only transposed the facts but incorrectly assigned 100 percent of its sales to Minnesota. Actually, Minnesota, unlike the District of Columbia, *allocated sales to the state in which the office of the origin of the sale was located.* Applying the correct formula, said the State, "would result in a much smaller portion of the total net income assignable to Minnesota than the appellant asserts, and when added to the portions attributable to other states having fair apportionment formulae would result in taxing no more than 100 percent of the appellant's income" (*id.*, Brief for the Respondent [Appellee], pp. 39-41).

It was this type of hypothetical abstraction by Northwestern States—far removed from the facts of the case and based on questionable assumptions—to which this Court addressed itself in its *Northwestern States* opinion. The hypothetical set forth by petitioner, on the other hand, illustrates the precise situ-

ation confronting it. It was by proof, and not by an abstraction, that petitioner showed its income being taxed not only by the District but by Delaware, Maryland and Michigan, as the Tax Court found (pp. 51-53, *supra*). We do not argue that the District's single-factor formula "could easily lead" to illegal taxation under some other set of facts, but rather that the formula *has led* to multiple taxation and undue burdens on commerce under the specific facts of this case, just as the Tax Court found (Finding No. 3, R. 437-438, 495; App. A, pp. 3a-4a, *infra*).

The duplication of tax, thus proved and found, was grossly discriminatory against interstate commerce, in that petitioner, manufacturing products in any of those states having three-factor apportionment formulae, paid a combined tax on approximately 166-2/3 percent of the net income from all business culminating in sales from that state to District customers, while another taxpayer, both manufacturing and selling in the District, would be taxed on only 100 percent of its income.

Double taxation, and discrimination against interstate commerce, of that order are unconstitutional. If two jurisdictions are taxing the same income to such an extent, one or the other is wrong—perhaps partially each. The proof here, however, is clear that the District, and only the District, is wrong.

To begin with, there is the expert testimony, heretofore reviewed (pp. 38-43), which shows the unreasonable and arbitrary character of the District's so-called formula. In addition, there is the fact that all, or nearly all, of the apportionment formulae of states imposing income taxes apportion substantial parts (usually about two-thirds) of net income to the place

of manufacture (R. 258-260; note 13 on p. 14, *supra*). The proposed "Uniform Division of Income for Tax Purposes Act", approved by the American Bar Association and the National Conference of Commissioners on Uniform State Laws, would do that (R. 458), as would the formula recommended by the District's Finance Officer but so far not adopted by the District Commissioners (R. 463-472, 485-486). This Court has repeatedly approved such formulae (pp. 30-35, *supra*).

If everybody else does it one way, and the courts, especially this Court, have consistently approved of that way, and the District method is inconsistent and incompatible, the District is under a heavy burden to show that it is right and everyone else, including the courts, is wrong. That is not all, however. Since the apportioned taxes in the other states properly reflect the contribution to net income made by the factors of production and are unquestionably valid, it is the unapportioned District tax that must yield in order to remove the discrimination. *Gwin, White & Prince, Inc.* v. *Henneford, supra*, 305 U.S. at 439-44.

C. Impact of the Decision

If the decision below is upheld, even on the narrow grounds of an asserted failure of proof, a blanket approval will be assured for the imposition of net income or franchise taxes on the entire profit realized from every interstate sale into the taxing jurisdiction, without apportionment to reflect the contribution made by business activities in other jurisdictions. The standard of proof demanded by the Court of Appeals, under which an unreasonable and arbitrarily disproportionate burden can be shown only by impossibly precise cost accounting (and must be established by

each separate taxpayer, from the facts of its own case) (*supra,* pp. 37-41), and under which multiple taxation can apparently be established only by showing identity of factor definitions, accounting procedures, and deductions (*supra,* pp. 53-54), means that such taxes will be beyond hope of successful attack on constitutional grounds.

At the present time, only the District is shown to be "apportioning" taxable net income exclusively on the basis of the factor of location of customers. (See note 13, *supra,* p. 14.) The overall impact of that so-called apportionment formula upon national commerce is, therefore, limited for the present. Other states may, however, have been deterred only by the fear that such a formula is unconstitutional. If this Court gives its approval to such a method of taxing income from interstate transactions, the method is sure to spread. States which regard themselves more as "market states" than as "producing states" will be led to adopt such method as an attractive device for making outside business pay for benefits to the local citizenry, thus exacting a toll from business done elsewhere and elsewhere amply taxed. States desiring to attract new industry will be moved to adopt the method because it imposes less tax on the locally based company which sells elsewhere and a heavier burden on the outside corporation which sells into the state. Whenever one state adopts the method, its neighbors will be moved to do the same in order to compete.[43]

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[43] Such has been the history of the spread of the destination-sales factor (as distinguished from the sales-origin or sales-office factor) as one element of the widely used three-factor formula. "State Taxation of Interstate Commerce", Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the House of Representatives, pur-

This is not alone a problem for large national corporations like petitioner. It has recently been estimated by a Congressional subcommittee that no less than 120,000 corporations, including many small family enterprises, engage in interstate commerce and thus are potentially subject to tax in more than one jurisdiction.[44] The taxes which they may be required to pay in excess of their competitors in the local market —particularly if this method of determining tax should spread—may be important to their survival.

The objectives to increase state revenues for needed services and to attract new industry by creating a favorable tax climate are commendable in themselves, but not when they are accomplished by erecting what amounts to a tariff wall of discrimination against interstate commerce and by subsidizing local business at the expense of that originating in other states. The Constitution, as Mr. Justice Cardozo said for the unanimous Court in *Baldwin* v. *G. A. F. Seelig, Inc.*, 294 U.S. 511, 523, 527, "was framed upon the theory that the peoples of the several states must sink or swim together, and that in the long run prosperity and salvation are in union and not division. . . . Neither the power to tax nor the police power may be used by the state of destination with the aim and effect of establishing an economic barrier against competition with the products of another state or the labor of its residents. Restrictions so contrived are an un-

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suant to P.L. 86-272, House Report No. 1480, 88th Cong., 2d Sess. 123-128 (June 15, 1964). The effects of the use of destination-sales as one of three factors are comparable to the present situation, but much more moderate (and perhaps permissible on that ground), since substantial (two thirds) weight is given to factors reflecting the capital and services employed to produce the income.

[44] "State Taxation of Interstate Commerce", *supra*, note 43, at pp. 77, 593.

reasonable clog upon the mobility of commerce. They set up what is equivalent to a rampart of customs duties designed to neutralize advantages belonging to the place of origin. They are thus hostile in conception as well as burdensome in result."

Those words of Mr. Justice Cardozo were reiterated by Mr. Justice Jackson, speaking for the Court, in *H. P. Hood & Sons, Inc.* v. *Du Mond,* 336 U.S. 525, 532-533, and he added (at pp. 538-539), "The material success that has come to inhabitants of the states which make up this federal free trade unit has been the most impressive in the history of commerce, but the established interdependence of the states only emphasizes the necessity of protecting interstate movement of goods against local burdens and repressions. . . . What fantastic rivalries and dislocations would ensue if such practices were begun!"

CONCLUSION

The decision of the Court of Appeals should be reversed, with directions to affirm the decision of the Tax Court, and with costs in all courts to petitioner.

Respectfully submitted,

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APPENDIX A

DISTRICT OF COLUMBIA TAX COURT

Findings of Fact and Opinion

[as filed January 29, 1962, with amendments of February 27, 1962 incorporated]

These two cases have been consolidated for hearing and disposition. They involve the same questions of taxation for the calendar years 1957 and 1958. The assessing authority of the District of Columbia assessed the petitioner substantial franchise taxes. The petitioner here appeals from the assessments and claims that they are invalid. The respondent insists that the assessments are proper and justified under Title X of the District of Columbia Income and Franchise Tax Act of 1947.[1]

Findings of Fact

Most of the facts are stipulated and, together with exhibits, are found as stipulated.

The Court finds additional facts for the taxable years involved as follows:

1. The petitioner had business establishments in 38 states and the District of Columbia. The principal office or headquarters of the petitioner was in Detroit, Michigan. There was an executive office in New York City in which were located the financial executives of the petitioner.

2. (a) The factories of the petitioner were located principally in the states of Michigan, Ohio, Illinois, Indiana, New York, New Jersey, Delaware, Maryland, Missouri, California and Georgia. There was no factory or assembly plant of the petitioner in the District of Columbia.

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[1] Title X of Chapter 15 (Sections 47-1580 and 47-1580a), D. C. Code, 1951 Edition.

(b) Approximately fifty per centum of petitioner's physical properties, including factories, equipment and inventories, and payroll amounts were located or paid in Michigan.

(c) All Cadillac automobiles and all heavy trucks of the petitioner's GMC and Coach Divisions were manufactured in Michigan. In addition, many component parts of automobiles and quantities of Buick, Oldsmobile and Pontiac automobiles were manufactured in that state.

(d) At the petitioner's factory or plant in Maryland there were assembled Chevrolet automobiles for shipment to the District of Columbia and the surrounding states.

(e) At the petitioner's factory or plant in Delaware there were assembled Buick, Oldsmobile and Pontiac automobiles for shipment to the District of Columbia and the surrounding states.

3. (a) The petitioner in accordance with the statutes of the respective states filed income tax returns and paid income taxes for the taxable years involved as follows:

Year	State	Amount
1958	Delaware	$ 127,844.95
1957	Maryland	510,792.31
1958	Maryland	271,425.75
1957	Michigan	8,955,799.55
1958	Michigan	6,940,309.50

(b) A portion of the net income of petitioner derived from the segment of the petitioner's business consisting of the manufacture of products without, and sale within the District of Columbia was taxed by the above mentioned states, pursuant to apportionment formulas (with factors of property, payroll and sales), as provided by their laws.

4. At a conference between the representatives of the petitioner and of the Finance Officer of the District of Columbia, after notice of the latter's intention to assess the deficiencies here involved, the representatives of the

petitioner protested the contemplated assessment and stated that the apportionment made was out of all proportion to the business carried on in the District by the petitioner; and that the formula used was basically unfair because it did not take into consideration or employ factors which were important in the production of income from manufacturing; and suggested that factors other than sales should be employed in apportioning the income of the petitioner and suggested that the property and payroll factors should be considered.

5. The segment of petitioner's business which was conducted both within and without the District of Columbia consisted of the manufacture of a certain number of automobiles and kindred products without the District and the sale thereof to customers within the District. The net income from this segment of petitioner's business was earned by a series of transactions beginning with the manufacture of products in several states and ending with the sale to customers in the District. While the net income was not realized until sale, it was earned in part by manufacture of the products sold, including in addition to actual manufacture, procurement of material, financing, use of property and administration.

6. The method used by the assessing authority of the District attributed to the District 100 per centum of the net income derived by the petitioner from that segment of its business which consisted of the manufacture without, and sale of the products within the District. The percentage thus determined was out of all reasonable proportion to the trade or business carried on or engaged in by petitioner within the District.

Opinion

The assessing authority of the District of Columbia assessed the petitioning taxpayer deficiencies in franchise tax and interest as follows: for the calendar year 1957 a

deficiency of $268,585.40, plus interest of $35,379.40 or a total of $303,964.80; and for the calendar year 1958 a deficiency of $167,468.44, plus interest of $11,860.89 or a total of $179,329.33. The total amount of both deficiencies, $483,294.13, was paid by the petitioner. These appeals followed. The petitioner claims that the deficiencies and interest in their entirety were erroneously assessed. On the other hand, the respondent contends that they were validly assessed.

For the reasons hereafter stated the Court holds that deficiencies and interest for the two taxable years in the total amount of $317,049.83, were erroneously assessed against, and collected from the petitioner.

Before stating the reasons for the above holding, the Court will consider and dispose of the constitutional questions raised by the petitioner to the extent that it is empowered so to do.

I

Constitutional Questions

The petitioner has raised three constitutional questions, namely, that in violation of the Constitution (a) the application of the formula results in the taxation by the District of Columbia of values without its borders or taxing jurisdiction, (b) the provision of the statute which exempts or relieves from taxation those corporations or unincorporated businesses which have no office, warehouse or place of business in the District, while imposing a tax on those who do have an office, warehouse or place of business in the District is unconstitutionally discriminatory, and (c) the attributing to the District of Columbia 100 per centum of the net income of the petitioner derived from that segment of its business, which consisted of the manufacture of products without, and sale thereof within the District,

resulted in a tax out of all reasonable proportion to its business carried on or engaged in within the District. The Court does not believe it can decide those questions because of the muddled condition of the status of the Court, that is to say, whether it is a court or an administrative agency.

It is clear that Congress attempted to make the Board of Tax Appeals a court, or, at least, take away its administrative function as *"a constituent member of the assessing authority"* by the Act of July 10, 1952, (see third paragraph of Section 47-2402, D. C. Code, 1961 Edition). Such attempt, however, has been held to be abortive.

In *Hosmer* v. *District of Columbia*, 77 U. S. App. D.C. 295, 135 F. 2d 654, 71 W.L.R. 932, Judge Prettyman held that the then Board of Tax Appeals was not a court, but *"a constituent member of the assessing authority"*. He held the same in *Hamilton National Bank* v. *District of Columbia*, 85 U.S. App. D.C. 109, 176 F. 2d 624, 77 W.L.R. 1102. After those two decisions Congress attempted, at least, to negative or correct the effect of those decisions by providing in the Act of July 10, 1952, making the Board of Tax Appeals the "District of Columbia Tax Court", that *"the said District of Columbia Tax Court shall not be deemed or held to be a constituent member of the assessing or taxing authority of the District of Columbia"*. In a recent case, *District of Columbia* v. *Brady*, 109 U.S. App. D.C. 324, 288 F. 2d 108, Judge Prettyman, however, held as follows:

> "Moreover, under the Code, the ultimate exhaustion of the *administrative remedy, i.e.*, a decision by the Tax Court, an 'independent agency' in the District Government, or indeed even the filing of an appeal with that Court, precludes the taxpayer from filing suit under his common-law remedy. If the exhaustion of the *administrative remedy* is a bar to a common-law action *a fortiori* it can in no sense be a condition precedent to such a suit.

> "We conclude that Dr. Brady's failure to exhaust his administrative remedy did not preclude his bringing action in the District Court.[2] "

The Tax Court of the United States is by the organic Act, a designated administrative agency.[3] In several cases in that Court it was held that it could decide constitutional questions, although serious doubts about that function have been expressed by some of the judges of that Court. This Court is, however, uncertain as to its power to decide a constitutional question and believes that until the matter is more clearly or definitely settled by the United States Court of Appeals or by a declaratory act of Congress, it should not decide the questions, but merely note, as it here does, that the constitutional questions were here raised. The Court, therefore, will decide the other issues persented under the law as it exists.

II

The Basis for Taxation

These cases involve franchise taxes imposed by Section 47-1571a[4] of the Code, which provides as follows:

> "For the privilege of carrying on or engaging in any trade or business within the District and receiving income from sources within the District, there is hereby levied for each taxable year a tax at the rate of 5 per centum upon the taxable income of every corporation, whether domestic or foreign."

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[2] It is interesting to note that the same result would have occurred from a holding that the Tax Court was a court and not an administrative agency.

[3] Actually it is a court. There is, and has been for sometime, a movement to have it declared to be a Federal Court.

[4] Section 2 of Title VII, D. C. Income and Franchise Tax Act of 1947.

The question which the Court must answer is: what is the portion of the petitioner's net income that was fairly attributable to the trade or business carried on by it within the District of Columbia during the taxable years involved, 1957 and 1958, and other net income from sources within the District—within the meaning of that part of Section 47-1580[5] reading as follows:

> "* * *. The measure of the franchise tax shall be that portion of the net income of the corporation * * * as is fairly attributable to any trade or business carried on or engaged in within the District and such[6] other net income as is derived from sources within the District; * * *."

The question presented in these cases relates solely to that segment of the petitioner's business which involves the manufacture of a certain number of automobiles and kindred products outside the District of Columbia and the sale thereof to customers within the District. To use the language of the many regulations, the trade or business contemplated by the Act is "the *manufacture and sale* or *purchase and sale* of tangible personal property". The Commissioners have correctly interpreted the term "trade or business" to include a combination of either "manufacture" *and* "sale" or of "purchase" *and* "sale". Otherwise, the regulations would have read "manufacture, purchase or sale". (See, among others, Section 10-2(c)(1)(a), Regulations of August 6, 1953.) The regulations in the respect indicated are consonant with the legally established fact that, "income may be defined as the gain derived from capital, from labor, or from both combined" *Strattons Independence, Ltd.* v. *Howbert*, 231 U.S. 399, 415, 58 L. Ed. 285, 34 S. Ct. 136; *Doyle* v. *Mitchell Bros. Co.*, 247 U.S. 179, 185, 62 L. Ed. 1054, 38 S. Ct. 467; *Eisner*

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[5] Section 1 of Title X, ibid.

[6] The word "such", apparently was ineptly inserted. It has no meaning or significance.

v. *Macomber*, 252 U.S. 189, 207, 64 L. Ed. 521, 40 S. Ct. 189. (And we might add "enterprise".) The cases, *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113, 65 L. Ed. 165, 41 S. Ct. 45 and *Bass, Ratcliff and Gretton, Ltd.* v. *State Tax Com.*, 266 U.S. 271, 69 L. Ed. 282, 45 S. Ct. 82, have frequently been cited to support one factor formulas, and in that connection they will be discussed with other similar cases in a later portion of this opinion. At this point they are cited to show that the "trade or business" with which we are here concerned includes both the manufacturing as well as the selling of the merchandise involved; that the net income therefrom is earned by both activities;[7] and that, while net income is not "*realized*" until sale, it is earned in part by the manufacture of the article sold. In the *Underwood Typewriter Co.*, case (254 U.S. at page 120) is the following:

> "The profits of the corporation[8] were largely earned by a series of transactions beginning with manufacturing in Connecticut and ending with sale in other states."

Likewise in the *Bass, Ratcliff & Gretton* case (266 U.S. at page 282) we find this:

> "So in the present case we are of opinion that as the Company carried on the unitary business of manufacturing and selling ale, in which its profits were *earned* by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places—the process of manufacturing *resulting* in no profit until it ends in sale, etc." (Emphasis supplied.)

And as the Supreme Court said in *Hans Rees' Sons* v. *North Carolina*, 283 U.S. 123, 75 L. Ed. 879, 51 S. Ct. 385:

> "Undoubtedly the enterprise of a corporation which manufactures and sells its manufactured product is

[7] Together, of course, with administrative activities.

[8] Similar to the petitioner herein.

ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits."

III

Regulation and Formula Must Comply With Law

At the outset it should be pointed out that, *legally*, any formula or method for the apportionment or determination of net income taxable by the District must, in respect of multistate businesses, accord with that part of Section 47-1580a[9] of the Code, which is in this language:

> "* * * *. If the trade or business of any corporation * * * is carried on or engaged in both within and without the District, the net income derived therefrom shall, for the purposes of this article be deemed to be income from sources *within* and *without* the District. * * *." (Emphasis supplied.)

In *McCeney* v. *District of Columbia*,[10] 97 U.S. App. D.C. 282, 285, 230 F. 2d 832, 84 W.L.R. 625, Judge Washington, commenting on the failure of the Commissioners to follow the statute in promulgating regulations, said:

> "Section 47-1601 is explicit that the tax is to be paid on the 'market value' of the interest involved. This requires, we think, that the actual market value of the interest be determined as nearly as possible. Although Section 47-1607 provides that the value of remainder interest is to be determined by subtracting from the value of the property the value of the life interests, determined in such manner as the Commissioners' regulations prescribe, *this does not authorize the Commissioners to adopt regulations which result in disregarding the directive of the statute to tax only the market value of the interest. It is axiomatic that administrative rules must be consistent*

[9] Section 2 of Title X, District of Columbia Income and Franchise Tax Act of 1947.

[10] Involved an inheritance tax.

with the statute under which they are promulated." (Emphasis supplied.)

See also: *Manhattan General Equipment Co.* v. *Commissioner*, 297 U.S. 129, 134, 80 L. Ed. 528, 56 S. Ct. 397; *Addison* v. *Holly Hill Fruit Products, Inc.*, 322 U.S. 607, 616, 88 L. Ed. 1488, 64 S. Ct. 1215; *Thompson* v. *Amalgamated Casualty Ins. Co.*, 207 F. 2d 214, 220.

Any formula or method which does not conform to, or comply with the plain and unambiguous directive or mandate of the law is, therefore, not legally permissible. For instance, if a corporation manufactures its products at its only plant in Maryland and sells them in the District, a formula with sales as the *sole* factor would be illegal, because under it the entire net income would be assigned to, or deemed to be from sources within the District. Likewise, if property be the sole factor, the formula would be legally improper, because all of the net income would be thereunder assigned to, or deemed to be from sources in Maryland.

It is interesting to note that, if the taxpayer has its office, manufacturing plant or other principal place of business in the District and sells some of its products or performs some of its services without as well as within the District, a formula with one factor of sales only does not necessarily violate the *letter* of the provision of the law that the income must be deemed to be from sources both within and without the District. Examples of that result are *District of Columbia* v. *Southern Railway Co.*, 107 U.S. App. D.C. 285, 277 F. 2d 84, 88 W.L.R. 277; *District of Columbia* v. *Evening Star Newspaper Co.*, 106 U.S. App. D.C. 360, 273 F. 2d 95, 87 W.L.R. 1371; and *Thompson's Dairy, Inc.* v. *District of Columbia*, D.C.T.C., Docket Nos. 1731 and 1733, Opinion No. 988. In those cases a one factor formula was used, but its use resulted in loss of revenue to the District to which it was economically entitled from the use by the taxpayers of property and ad-

ministrative services within the District. A formula with the factors of property, payroll and sales would have saved that revenue, which no doubt, is why the Finance Officer of the District has repeatedly requested and urged the Commissioners to adopt the three factor formula for consistent use, that is to say, for the taxation of both resident and nonresident taxpayers.[11]

It should, moreover, be observed at this point that the provision for regulations apply in the statute to instances only where the net income of the taxpayer is "deemed to be income from sources within and without the District". Section 47-1580a of the Code, in part, provides:

> "Where the net income of a corporation or unincorporated business is derived from sources both within and without the District,[12] the portion thereof subject to tax under this article *shall* be determined under regulation or regulations prescribed by the Commissioners." (Emphasis supplied.)

Apparently, where the business is carried on *solely* in the District and the entire net income arises therein regulations or formulae are not necessary. They are only needed where the income is to be deemed to be from sources *both within* and *without* the District.

There are two suggestions or insinuations that need comment. The first is that, if all of a corporation's products manufactured outside the District are not sold therein, a one factor formula of sales would meet the requirement of the law, since it could be said that a part of the net income from the (entire) business of the corporation is deemed to

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[11] Formal submission of the three factor formula to the Commissioners and action thereon will appear from the Appendices A, B, and C to this opinion.

[12] That is to say, when the business is carried on within and without the District. See preceding portion of Section 47-1580a of the Code.

be from sources without the District. The fallacy of that idea is due to overlooking the fact that the "trade or business" covered by the act is that relating to the District, which is a combination of "manufacturing and selling" and which is carried on in the manner stated in the *Underwood Typewriter Co.*, and *Bass, Ratcliff & Gretton* cases, above cited, both within and without the District. To use an extreme case as the acid test, in *Smoot Sand & Gravel Co.* v. *District of Columbia*, 104 U.S. App. D. C. 292, 261 F. 2d 758, 85 W.L.R. 1078, all of the taxpayer's products were manufactured or processed without the District. Ninety-five per centum was sold in the District, and that percentage of its net income was held to be taxable by the District[13] under a one factor formula of sales. If all of the products had been sold, one hundred per centum of its income would have been held taxable by the District under that formula.

The other suggestion is that since *net* income results from the deduction from *gross* income of all expenses, including those relating to manufacturing, the requirement for the apportioning of net income within and without the District, where the business is carred on both within and without the District, is met by reason of such deduction. That suggestion, in the first place, overlooks the fact that all expenses, including that relating to selling the products, are deducted. Moreover, what we are trying to do in these types of cases is to find the locale of the commercial activity and what portion of the net income is fairly attributable thereto. The usual computation of net income involving the inclusiox of items in gross income and deducting items of expense therefrom is not here involved. For practical

[13] The U. S. Court of Appeals evidently overlooked the mandate of the statute as to apportioning the income within and without the District, or it may have been influenced by the fact that Smoot Sand & Gravel Company had its principal office in the District where all of its fiscal affairs were handled. Two-thirds, however, of its expenses were incurred in Maryland and Virginia.

purposes what is important in cases of this kind is the determination of what portion of net income results from the use of property, from the activities of administration and the like and from the process of selling.

For the reasons stated the Court does not believe that a one factor formula of sales can, consistent with the Act, be used where, as here, the trade or business involved is the manufacture of tangible personal property without, and the sale thereof within the District.

IV

The Eastman Kodak Company and the Panitz Cases

A great deal of confusion has arisen concerning a case decided some years ago by the United States Court of Appeals under the old District of Columbia Revenue Act of 1939, namely *Eastman Kodak Co.* v. *District of Columbia*, 76 U.S. App. D.C. 339, 131 F. 2d 347. In that case this Court, then the Board of Tax Appeals, upheld an income tax against Eastman Kodak Company on the entire net income from sales of its products in the District of Columbia. The amount of net income allotted to the District was computed by assigning to the District that proportion of the taxpayer's income as sales in the District bore to sales everywhere. The United States Court of Appeals affirmed that holding. Several things must be kept in mind in relation to the *Eastman Kodak Company* case and to these cases. They arose under two differing statutes namely, the District of Columbia Revenue Act of 1939, and the District of Columbia Income and Franchise Tax Act of 1947, respectively. The taxes imposed on corporations by the two acts are different in several important and essential respects. *Flint* v. *Stone Tracy Co.*, 220 U.S. 107, 55 L. Ed. 389, 31 S. Ct. 342. The former imposed, as far as corporations were concerned, a pure income tax, while the latter levies a privilege tax, measured, it is true, by net income. The *Eastman Kodak Company* case was decided, certainly

in this Court, on the severance theory, that is to say, that no income was earned until the property involved was sold—that "the fruit must be shaken from the tree", to speak figuratively; and that the place wherein the sale took place was where the income was realized. This Court and the Court of Appeals relied upon several Federal cases which were decided before the enactment of Section 119(c) of the Internal Revenue Code of 1939 (February 10, 1939).[14] The Federal law, as it existed earlier, and upon which those cases were based, was essentially the same as the District of Columbia Revenue Act of 1939. Section 119(c) of the Internal Revenue Code of 1939, however, materially changed the Federal law; and provided that income "from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States, *or produced (in whole or in part) by the taxpayer without and sold within the United States, shall be treated as derived partly from sources within and partly from sources without the United States*", which is substantially what that part of Section 47-1580a quoted above provides, *as far as this case is concerned,* that is to say, involving the manufacture of personal property *without,* and its sale *within* the District. It is interesting to note that Eastman Kodak Company sought to have the United States Court of Appeals determine the question of tax liability on the basis of the then new Section 119(c) of the Internal Revenue Code of 1939, but that Court refused to do so and as stated above affirmed the above mentioned decision of this Court.

It should here be noted that the most important, and indeed, controlling difference between the District law involved in the *Eastman Kodak Company* case and the District of Columbia Income and Franchise Tax Act of 1947 is that the former law did not, as does the latter (Section 47-1580a of the Code) provide that where the taxpayer's

[14] See the cases cited in Footnote 6, 76 U.S. App. D.C. page 340.

business is carried on within and without the District the net income, for the purpose of measuring the tax, must be deemed to be from sources *within* and *without* the District. Another difference between the 1939 and 1947 District laws is that under the former, since the income was earned where the sale was made, the passing of title, which usually completes a sale of personal property, was determinative, while under the latter the passing of title is of no determinative effect, which was due to, or came about by the following. The decision in the *Eastman Kodak Company* case in favor of the District was a Pyrrhic Victory. The manufacturers quickly adopted a plan whereby title and possession of goods shipped from points outside to customers within the District passed to the customers at a point outside the District. The United States Court of Appeals in *Electric Storage Battery Co. v. District of Columbia*, 81 U.S. App. D.C. 135, 155 F. 2d 867, set aside a District of Columbia income tax where the title to goods in a f.o.b. shipment passed to the customer outside the District. That and other cases, and the effect of the *Eastman Kodak Company* case and its use by the manufacturers resulted in the promotion by the District of the enactment of the District of Columbia Income and Franchise Tax Act of 1947,[15] which, as far as corporations and unincorporated businesses are concerned, has two principal advantages to the District, namely, nullification of the effect of the passing of title and the elasticity of a franchise tax which could be measured by income attributable to business carried on in the District, regardless of the locale of the sale or the real source of income in the concept of pure income taxation. Congress did, however, as above observed, provide, as protection for multistate businesses, that where the business was carried on both within and without the District the net income from such business had to be considered income from sources without, as well as within the District.

[15] Chapter 15 of Title 47, D.C. Code, 1951 Edition.

Panitz v. *District of Columbia*, 74 U.S. App. D.C. 284, 122 F. 2d 61, 69 W.L.R. 891, has been frequently cited in support of a one factor formula of sales. Like the *Eastman Kodak Company* case, the law involved in the *Panitz* case was materially different from the Income and Franchise Tax Act,—even more so. The *Panitz* case arose under the old Business Privilege Tax Act in the District of Columbia Revenue Act of 1937. It simply imposed an excise tax measured by gross receipts from business carried on in the District "without any deduction therefrom on account of the cost of the property sold, the cost of materials, labor or services or other costs * * * or any expense whatsoever". All that was there decided was that a tax on the gross receipts from the commercial activity of sales (as required by the law) in the District was proper. There was no provision in the taxing statute requiring any apportionment, as does the present law, nor any provision similar in the slightest degree to the requirement in the current Act that, if the business is carried on both within and without the District, the net income must be apportioned accordingly.

The provision in Section 47-1580a of the Code providing that, if the trade or business is carried on within and without the District of Columbia, the net income must be deemed to be income from sources without, as well as within the District, has not only been ignored in the regulations, but has received no comment by counsel for the District in their brief in this case, although this Court has repeatedly referred to that provision as not only important, but controlling as well. The Court is at a loss to understand the failure on the part of counsel to discuss the provision in relation to these cases and to the facts stipulated by the parties.

V

Other Cases Cited To Support A One Factor Formula

Several Supreme Court cases have frequently been cited to support a one factor formula in the taxation of net income or gross receipts from unitary businesses or corporations. The cases do support the use of such a formula, *if the particular statute so provides.* In none of the cases did the taxing statute provide, as does the District law, for the apportionment within and without the taxing jurisdiction where the business is carried on within and without that area. The cases, briefly discussed, are the following:

Maine v. *Grand Trunk Rwy. Co.*, 142 U.S. 217, 35 L. Ed. 994, 12 S. Ct. 121. Really not an apportionment case. The method to be used was specifically spelled out in the Maine statute.

Underwood Typewriter Co. v. *Chamberlain, supra.* Unlike or exactly opposite from the District statute, the Connecticut law specifically provided that, if the business was carried on both within and without the State, the tax should be computed by the use of a one factor formula of property within Connecticut.

Bass, Ratcliff & Gretton, Ltd. v. *State Tax Commission, supra.* The taxing statute provided specifically for a one factor formula of real and personal property in New York.

National Leather Co. v. *Massachusetts*, 277 U.S. 413, 72 L. Ed. 935, 48 S. Ct. 534. Taxing statute specifically provided for use of a one factor formula of real and personal property employed in business in Massachusetts.

It should be added that in respect of the *Underwood Typewriter Co., Bass, Ratcliff & Gretton, Ltd.* and *National Leather Co.* cases the Supreme Court in the *Hans Rees' Sons* v. *North Carolina, supra,* indicated, as did our Court of Appeals in *Smoot Sand & Gravel Co.* v. *District of Columbia, supra,* that the decisions sustaining the one factor

formulas turned largely upon the failure of evidence. This is what the Supreme Court said in the *Hans Rees' Sons* case.

> "* * * Evidence which was found lacking in the Underwood and Bass Cases is present here. *These decisions are not authority for the conclusion that, where a corporation manufactures in one state and sells in another, the net profits of the entire transaction, as a unitary enterprise, may be attributed, regardless of evidence, to either state.* In the Underwood Case, it was *not* decided that the entire net profits of the total business were to be allocated to Connecticut because that was the place of manufacture, or, in the Bass Case, that the entire net profits were to be allocated to New York because that was the place where sales were made. In both instances, a method of apportionment was involved which, as was said in the Underwood Case, 'for all that appears in this record, reached, and was meant to reach, only the profits earned within the state.' The difficulty with the evidence offered in the Underwood Case was that it failed to establish that the amount of net income with which the corporation was charged in Connecticut under the method adopted was not reasonably attributable to the processes conducted within the borders of that state; and in the Bass Case the Court found a similar defect in proof with respect to the transactions in New York." (Emphasis supplied.)

New York v. *Latrobe*, 279 U.S. 421, 73 L. Ed. 776, 49 S. Ct. 377. Unlike the District law, the New York statute specifically provided that the license fee for a corporation be based upon that proportion of its corporate stock that gross assets employed within the state bore to its gross assets employed everywhere. *It was a corporate stock valuation case.*

Ford Motor Co. v. *Beauchamp*, 308 U.S. 331, 48 L. Ed. 304, 60 S. Ct. 273. Unlike the District statute, Texas Annotated Civil Statute, Article 7084 specifically imposed "a franchise tax * * * based upon that proportion of the outstanding capital stock, surplus and undivided profits, plus the amount of outstanding bonds, notes and debentures, other than those maturing less than a year from date of issue, as gross receipts from its business done in Texas bears to the total gross receipts of the corporation from its entire business, * * *."

International Harvester Co. v. *Evatt*, 329 U.S. 416, 91 L. Ed. 390, 67 S. Ct. 444. The Ohio statute specifically provided the formula to be used. Incidentally, the Ohio statute provided a *two* factor formula, namely, of property and "business done" in Ohio.

Actually, all that the foregoing Supreme Court cases decided was that the use of the formulas specifically provided in the various statutes did not violate the Constitution.

A state case, *Household Finance Co.* v. *State Tax Com.*, 212 Md. 80, 128 A. 2d 640, relied upon to support the use of a one factor formula should be briefly discussed. That case really supports the principle that, if business is carried on within and without the District the net income must be deemed income within and without the District. The Maryland statute required the State Tax Commission, in the valuation of corporate stock relating to Maryland, to exclude business and property outside the state. The order of the State Tax Commission did not follow the law. On appeal to the Court of Appeals of Maryland the order of the Commission was modified to comply with the law. Moreover, a statutory formula or method was provided.

VI

The Gallant Case

District of Columbia v. *Gallant, Incorporated,* U.S. App. D.C. , 290 F. 2d 745, dealt with a regulation adopted by the Commissioners on August 6, 1953, for the enforcement and administration of the foregoing provisions of the Income and Franchise Tax Act.[16] The portion of the regulation with which we are here concerned is Section 10-2(c). The first sentence comports with the Act. It is the following:

> "If the trade or business is carried on or engaged in *wholly* within the District, the entire net income from trade or business shall be *allocated* to the District." (Emphasis supplied.)

The next portion of the regulation, Subsection (1)(a) of Section 10-2(c), attempts to prescribe, or has for its sole purpose the prescribing of a formula for the determination of the net income taxable by the District, that is to say, "*fairly* attributable" to any trade or business carried on in the District. The United States Court of Appeals in the *Gallant* case held that the subsection was *valid*, but that it failed in its purpose, or, to use the language in the opinion, "failed to provide a 'formula' as the term is ordinarily understood in the regulation". Later in the opinion is found this language (290 F. 2d at page 748):

> "However, irrespective of the authority of the Assessor, the Tax Court itself cannot be precluded, for lack of a regulatory formula, from determining the income which is fairly apportionable to the District. Cf. *McCeney* v. *District of Columbia*, 97 U.S. App. D.C. 282, 230 F. 2d 832 (1956). The Tax Court is, under Section 47-2403, to hear and determine 'all questions

[16] Chapter 15 of Title 47, D.C. Code, 1951 Edition.

arising' on the appeal—here the question of what income is fairly attributable to the District—and it may 'reduce or increase' the assessment as required under its determination of such questions.

"The case is remanded to the Tax Court for further proceedings not inconsistent with this opinion. The Tax Court is directed to determine the amount of the income which is fairly attributable to the District by applying the August 6, 1953, regulations, including if necessary the use of such formula or formulae as the Tax Court deems best suited for determination of that question in this case. * * *"

In Footnote numbered 4, relating to the regulation of August 6, 1953, is the following: "If a valid and pertinent regulation is promulgated by the Commissioners, the Tax Court must obey it and properly apply it." It is not supposed that the Court of Appeals meant that any regulation adopted by the Commissioners relating to the subject matter here involved should be given retroactive effect in face of the well established principle that such cannot be done if, as decided in the *Gallant* case, there was a valid regulation in effect during the prior year. *District of Columbia* v. *Radio Corporation of America,* 98 U.S. App. D.C. 119, 232 F. 2d 376, 84 W.L.R. 918, cert. denied, 352 U.S. 845, 1 L. Ed. 2d 51, 77 S. Ct. 44. But assuming that the United States Court of Appeals might have intended an exception or relaxation of the rule and intended that any new regulation be given retroactive effect, as was assumed in this Court's Memorandum on Remand in the *Gallant* case, this Court is of the opinion that, for the reasons stated in that memorandum, to which reference is here made to avoid repetition, the regulation adopted by the Commissioners on July 14, 1961, purporting to relate or pertain to the foregoing provisions of the Income and Franchise Tax Act (See Sections 47-1580 and 47-1580a of the Code) is invalid. The principal objection to the July 14,

1961, regulation is that to apply it in this case to the trade or business involved would violate the plain and unambiguous provision of Section 47-1580a of the Code that "If the trade or business of any corporation * * * is carried on or engaged in both within and without the District, the net income derived therefrom shall, for the purposes of this article, be deemed to be income from sources within and without[17] the District." The Court is of the opinion, therefore, that the use of the July 14, 1961, regulation in this case would be improper.

VII

The Best Suited Formula

In the light of the *Gallant* case, the Court believes that it is its duty to determine the amount of net income that was fairly attributable to the District of Columbia within the meaning of Section 47-1580 and 47-1580a of the Code, and to use such formula or formulae as will be agreeable to, and not violative of any provisions of those sections. This Court assumes, of course, that the United States Court of Appeals requires that in adopting a formula this Court follow all pertinent provisions of the taxing statute. With that in mind and considering the nature and extent of the trade or business carried on by the petitioner in relation to the District, that is to say, the manufacture of a certain quantity of products and administrative activities without the District and the sale of those products within the District, the Court is of the opinion that a formula is necessary for the determination of the portion of petitioner's net income which was fairly attributable to business carried on within the District within the meaning of

[17] It is important to note that the use of the phrase "*within and without the District*" shows that the term "trade or business" includes that which is done without as well as within the District, otherwise the provision would be meaningless or at least, unnecessary, since there would never be any occasion for its use.

Section 47-1580 and 47-1580a of the Code; and that the formula best suited for that determination is the following:

The portion of petitioner's net income fairly attributable to the trade or business carried on or engaged in within the District of Columbia by the petitioner during the taxable years 1957 and 1958 shall be determined by multiplying its total net income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

1(a) The property factor is a fraction, the numerator of which is the average value of the petitioner's real and tangible personal property owned or rented and used by the petitioner in the District during the taxable year, except property from which petitioner derived net income subject to direct allocation under the regulations pertaining to the District of Columbia Income and Franchise Tax Act of 1947,[18] and the denominator of which is the average value of all the petitioner's real and tangible personal property owned or rented and used during the taxable year.

(b) Property owned by the petitioner is valued at its original cost. Property rented by the petitioner is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the petitioner, less any annual rental rate received by it from sub-rentals.

(c) The average value of property shall be determined by averaging the value at the beginning and ending of the taxable year.

[18] For example, real estate rented to tenants, the rents therefrom being "such other income as is derived from sources within the District", within the meaning of Sections 47-1580 and 47-1580a of the Code, the net income from which is taxable separately from that derived from "trade or business". *D. C.* v. *Evening Star Newspaper Co.*, 106 U.S. App. D.C. 360, 273 F. 2d 95, 87 W.L.R. 1371.

2(a) The payroll factor is a fraction, the numerator of which is the total amount paid in the District during the taxable year by the petitioner for compensation, and the denominator of which is the total compensation paid everywhere during the taxable year.

(b) Compensation is paid in the District, if:

(i) The individual's service is performed entirely within the District.

(ii) The individual's service is performed both within and without the District, but the service performed without the District is incidental to the individual's service within the District, or

(iii) Some of the service is performed in the District and (1) the base of operations, or, if there is no base of operations, the place from which the service is directed or controlled is in the District, or (2) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in the District.

3(a) The sales factor is a fraction, the numerator of which is the total sales by the petitioner in the District during the taxable year, and the denominator of which is the total sales by the petitioner everywhere during the taxable year.

(b) Sales of tangible personal property are in the District if:

(i) The property is delivered or shipped to a purchaser, including the United States, within the District of Columbia, regardless of the f.o.b. point or other conditions of the sale.

The foregoing formula is, incidentally, substantially similar to the formula provided for multi-state businesses

in the Uniform Division of Income for Tax Purposes Act,[19] and to that recommended by the Finance Officer to the Commissioners in a memorandum dated March 22, 1961, and tentatively approved by the Commissioners on March 30, 1961 (See Appendices "A", "B" and "C" to this opinion). The formula, however, is adopted, because, in the opinion of the Court, it is intrinsically the best suited under the facts and in view of the nature of the trade or business involved herein.

The parties have stipulated facts sufficient for the application of the foregoing formula.

The Court has not overlooked the decision in the *Gallant* case that the regulation providing a one factor formula of sales is valid in that case. That decision, however, must be considered in the light of the circumstances in that case, that is to say, that the taxpayer, Gallant Incorporated, was engaged primarily in "the purchase and sale", and *not* "the mnufacture and sale", with its principal office in the District, and sold the tangible personal property involved in that case *within* and *without* the District, which permitted the use of the sales factor only, without violating the *letter* of the directive in the Act that the income had to be treated as earned, or from sources within and without the District, which would not be true in this case where the products involved were manufactured without but *sold* within the District. The use of the one factor formula in the *Gallant* case did deprive the District of Columbia of some revenue, but not all, so that, strictly speaking as observed above, the formula did not violate the letter of the law. The same is true of the *Southern Railway Co., Evening Star Newspaper Co.* and *Thompson's Dairy, Inc.*, cases.

[19] Approved, 1957, by the National Conference of Commissioners on Uniform State Laws and by the American Bar Association.

VIII

Computation of Taxes and Interest Due Year 1957

The factors of property, payroll and sales as defined in the formula may be stated as follows:

	Everywhere	District of Columbia	District Percentage
Property[20]	$6,247,160,370	$ 1,360,676	.0218%
Payroll	$2,662,072,037	$ 1,268,180	.0477%
Sales	$9,461,855,874	$37,185,704	.3930%
Combined Percentages			.4625%
Total Percentages divided by 3 (average)			.1542%

The portion of petitioner's net income for 1957 fairly attributable to the business of manufacturing and selling its products carried on within the District is computed as follows:

Total Net Income	$1,312,092,839.00	
Three Factor Apportionment Percentage		.1542%
Net Income Apportioned to District	$ 2,023,247.00	
Plus Other Net Income from Sources in the District	10,320.00	
Total Net Income Taxable by District	2,033,567.00	
Rate of Tax		5%
Tax Due by Petitioner	101,162.25	
Interest from 4/15/58 to 5/20/60 at ½ of 1% per month[21]	13,151.25	
Total Tax and Interest Due for 1957	$ 114,313.50	

[20] The item of "Property" includes both owned and rented property, the latter valued at 8 times the annual rent paid by petitioner.

[21] Section 47-1589c(b), D.C. Code, 1951 Edition, Supplement VIII, providing for interest on interest does not apply, because the amount assessed and demanded was exorbitant.

YEAR 1958

The factors of property, payroll and sales as defined in the formula may be stated as follows:

	Everywhere	District of Columbia	District Percentage
Property	$6,403,673,576	$ 1,326,209	.0207%
Payroll	$2,354,049,741	$ 1,233,787	.0524%
Sales	$7,853,393,381	$32,542,519	.4144%
Total Perecntages			.4875%
Total Percentages divided by 3 (average)			.1625%

The portion of the petitioner's net income for 1958 fairly attributable to business carried on within the District of Columbia by the petitioner is computed as follows:

Total Net Income	$653,396,893.00	
Three Factor Apportionment Percentage		.1625%
Net Income Apportioned to District	$	1,061,769.00
Plus Other Net Income from Sources in the District		15,418.00
Total Net Income Taxable by District		1,077,187.00
Rate of Tax		5%
Tax Due by Petitioner		53,859.35
Interest from 4/15/59 to 5/20/60 at ½ of 1 % per month[22]	$	3,770.15
Total Tax and Interest Due for 1958	$	57,629.50

[22] Section 47-1589 (b), D.C. Code, 1951 Edition, Supplement VIII, providing for interest on interest does not apply because the amount demanded in the assessment was exorbitant.

IX

Computation of Refund
Year 1957

The amount of franchise tax and interest for the year 1957 to be refunded to the petitioner is computed as follows:

	Tax	Interest	Total
Originally and Volunarily paid by Petitioner	$ 4,198.70	None	$ 4,198.70
Deficiency paid by Petitioner	268,585.40	$35,379.40	303,964.80
Total paid by Petitioner	$272,784.10	$35,379.40	$308,163.50
Amount due by Petitioner	101,162.25	13,151.25	114,313.50
Refund payable to Petitioner	$171,621.85	$22,228.15	$193,850.00

Year 1958

The amount of franchise tax and interest for the year 1958 to be refunded to the petitioner is computed as follows:

	Tax	Interest	Total
Originally and Voluntarily paid by Petitioner	$ 1,500.00	None	$ 1,500.00
Deficiency paid by Petitioner	167,468.44	$11,860.89	179,329.33
Total paid by Petitioner	$168,968.44	$11,860.89	$180,829.33
Amount due by Petitioner	53,859.35	3,770.15	57,629.50
Refund payable to Petitioner	$115,109.09	$ 8,090.74	$123,199.83

X

Conclusion

For the reasons hereinbefore stated the Court holds as follows:

Docket No. 1698. That a deficiency in franchise tax for the calendar year 1957 in the amount of $171,621.85, and interest thereon in the amount of $22,228.15, or a total of $193,850.00, were erroneously assessed against and collected by the respondent from the petitioner; and that the petitioner is entitled to a refund thereof with interest thereon at the rate of 4 per centum per annum from May 20, 1960, to the date of the payment of the refund.

Docket No. 1699. That a deficiency in franchise tax for the calendar year 1958 in the amount of $115,109.09, and interest in the amount of $8,090.74, or a total of $123,199.83, were erroneously assessed against, and collected by the respondent from the petitioner; and that the petitioner is entitled to a refund thereof with interest thereon at the rate of 4 per centum per annum from May 20, 1960, to the date of the payment of the refund.

Decisions will be entered for petitioner.

[signed] Jo. V. Morgan
Jo. V. Morgan,
Judge

[Appendices to opinion omitted. They will be found in R. 463-72.]

APPENDIX B

Constitutional Provisions, Statutes and Regulations Involved

1. UNITED STATES CONSTITUTION:

Art. I, Sec. 8, Clause 3:

"The Congress shall have Power—

* * * * *

"To regulate Commerce * * * among the several States, * * *;"

Fifth Amendment:

"No person shall * * * be deprived of life, liberty or property, without due process of law; * * *."

2. DISTRICT OF COLUMBIA INCOME AND FRANCHISE TAX ACT OF 1947, Act of July 16, 1947, 61 Stat. 328, ch. 258, as amended by Act of May 3, 1948, 62 Stat. 206, ch. 246:

Section 4(h), Article I, Title I (Section 47-1551c(h), D. C. Code 1961):

"Sec. 4. GENERAL DEFINITIONS—For the purposes of this article and wherever appearing herein, unless otherwise required by the context—

* * * * *

"(h) The words 'trade or business' include the engaging in or carrying on of any trade, business, profession, vocation or calling or commercial activity in the District of Columbia; and include the performance of the functions of a public office: *Provided, however,* That the words 'trade or business' shall not include, for the purposes of this article—

"(1) Sales of tangible personal property whereby title to such property passes within or without the District, by a corporation or unincorporated business

which does not physically have or maintain an office, warehouse, or other place of business in the District, and which has no officer, agent, or representative having an office or other place of business in the District, during the taxable year; or

"(2) Sales of tangible personal property by a corporation or unincorporated business which does not maintain an office or other place of business in the District and which has no office, agent, or representative in the District except for the sole purpose of doing business with the United States, but such corporations and unincorporated businesses shall be subject to the licensing provisions in title XIV of this article.

"For purposes of this proviso, the words 'agent' or 'representative' shall not include any independent broker engaged independently in regularly soliciting orders in the District for sellers and who holds himself out as such."

Sections 1 and 2, Article I, Title X (Sections 47-1580 and 47-1580a, D.C. Code, 1961):

"Sec. 1. PURPOSE OF ARTICLE.—It is the purpose of this article to impose (1) an income tax upon the entire net income of every resident and every resident estate and trust, and (2) a franchise tax upon every corporation and unincorporated business for the privilege of carrying on or engaging in any trade or business within the District and of receiving such other income as is derived from sources within the District: *Provided, however,* That in the case of any corporation, the amount received as dividends from a corporation which is subject to taxation under this article, and, in the case of a corporation not engaged in carrying on any trade or business within the District, interest received by it from a corporation which is subject to taxation under this article shall not be con-

sidered as income from sources within the District for the purpose of this article. The measure of the franchise tax shall be that portion of the net income of the corporation and unincorporated business as is fairly attributable to any trade or business carried on or engaged in within the District and such other net income as is derived from sources within the District: *Provided further,* That income derived from the sale of tangible personal property by a corporation or unincorporated business not carrying on or engaging in trade or business within the District as defined in title I of this article shall not be considered as income from sources within the District for purposes of this article, with the exception of income from sales to the United States not excluded from gross income as provided in title III, section 2(b)(13) of this article."

"Sec. 2. ALLOCATION AND APPORTIONMENT.—The entire net income of any corporation or unincorporated business, derived from any trade or business carried on or engaged in wholly within the District shall, for the purposes of this article, be deemed to be from sources within the District, and shall, along with other income from sources within the District, be allocated to the District. If the trade or business of any corporation or unincorporated business is carried on or engaged in both within and without the District, the net income derived therefrom shall, for the purposes of this article, be deemed to be income from sources within and without the District. Where the net income of a corporation or unincorporated business is derived from sources both within and without the District, the portion thereof subject to tax under this article shall be determined under regulation or regulations prescribed by the Commissioners. The Assessor is authorized to employ any formula or formulas provided in any regulation or regulations prescribed by

the Commissioners under this article which, in his opinion, should be applied in order to properly determine the net income of any corporation or unincorporated business subject to tax under this article."

3. DISTRICT OF COLUMBIA INCOME AND FRANCHISE TAX REGULATIONS, as promulgated August 6, 1953 and relettered by amendment of July 24, 1956:

"Sec. 10.2-(c). *Income Attributed to the District of Columbia.* If the trade or business is carried on or engaged in wholly within the District, the entire net income from trade or business shall be allocated to the District. If the trade or business is carried on partly within and partly without the District, that portion of the net income from trade or business to be apportioned to the District shall be determined as follows:

"(1) Income from sales of tangible personal property.

(a) Where income for any taxable year is derived from the manufacture and sale or purchase and sale of tangible personal property, the portion thereof to be apportioned to the District shall be such percentage of the total of such income as the District sales made during such taxable year bear to the total sales made everywhere during such taxable year. Every corporation and unincorporated business which carries on or engages in business in the District within the meaning of the words 'trade or business' as defined in the Act is, unless specifically exempted by some provisions of the Act, subject to tax. For the purpose of this regulation, the phrase 'District sales' shall mean all sales to District customers the income from which is fairly attributable to the trade or business carried on or engaged in within the

District, including solicitation in the District by salesmen or other representatives of the taxpayer, that portion of sales to customers outside the District the income from which is fairly attributable to the trade or business carried on in the District, and sales of tangible personal property the income from which is from District sources."

4. DISTRICT OF COLUMBIA INCOME AND FRANCHISE TAX REGULATIONS, as revised July 14, 1961:

"Sec. 10.2-(c). Income Attributed to the District of Columbia.—

(1) *Definitions.*—When used in this section

The words 'District sales' mean all sales to District customers the income from which is fairly attributable to the trade or business carried on or engaged in by the taxpayer within the District, that portion of sales to customers outside the District the income from which is fairly attributable to the trade or business carried on by the taxpayer within the District, and sales of tangible personal property the income from which is from District sources.

The words 'District customer' mean a person who purchases from a taxpayer tangible personal property located within or without the District and delivered to such person within the District, or who purchases tangible personal property the ultimate destination of which, after all transportation including transportation by the purchaser has been completed, is a point within the District, irrespective of means of transportation, f. o. b. point, place of passage of title, or other conditions of sale.

The words 'customer outside the District' mean a person who purchases from a taxpayer tangible per-

sonal property located within or without the District and delivered to such person without the District, or who purchases tangible personal property the ultimate destination of which, after all transportation including transportation by the purchaser has been completed, is a point without the District, irrespective of means of transportation, f.o.b. point, place of passage of title, or other conditions of sale.

The words 'District customer' and the words 'customer outside the District' include the United States of America; *Provided,* That in any case where income from sales of tangible personal property to the United States is, in accordance with the Act, income subject to tax as income from District sources, such sales shall be included as District sales.

(2) *Allocation.*—If the trade or business is carried on or engaged in wholly within the District, the entire net income from trade or business shall be allocated to the District.

(3) *Apportionment.*—If the trade or business is carried on partly within and partly without the District, that portion of the net income from trade or business to be apportioned to the District shall be determined, in the case of income from the manufacture and sale or purchase and sale of tangible personal property, as follows:

Where income for any taxable year is derived by the taxpayer from the manufacture and sale or purchase and sale of tangible personal property, the portion thereof to be apportioned to the District shall be such percentage of the total of such income as the District sales made during such taxable year bear to the total sales made everywhere during such taxable year. Income from sales to District customers and income from sales to customers outside the District, shall be deemed

to be fairly attributable to the trade or business carried on or engaged in by the taxpayer within the District, or to be from District sources, and such sales shall be included as District sales, as follows:

(a) SALES TO DISTRICT CUSTOMERS.—There shall be included as a District sale a sale of tangible personal property to a District customer where the taxpayer—

(i) Maintains within the District an office, warehouse, or other place of business for the purpose of selling personal property located within the District, or has an officer, agent, or representative (including an independent broker) having an office or other place of business in the District for the purpose of selling such property, or

(ii) Maintains within the District an office, warehouse, or other place of business or has an officer, agent, or representative (including an independent broker) in the District for the purpose of making sales of personal property by means of catalogue, descriptive literature, or sample, whether or not the personal property sold is located within the District, and whether or not orders or contracts for the purchase of such property are obtained, received, accepted, or entered into by the taxpayer within the District, or

(iii) Maintains within the District an office, warehouse, or other place of business, or has an officer, agent or representative (including an independent broker) in the District for the purpose of obtaining, receiving, accepting or entering into orders or contracts for the sale of personal property, whether or not the property which is the subject of such orders or contracts is located within the District, or

(iv) Solicits or promotes sales of personal property in the District through salesmen, officers, agents, or representatives, (including independent brokers)

whether or not such salesmen, officers, agents, or representatives have an office or other place of business within the District, and whether or not orders or contracts for the personal property sold are obtained, received, accepted, or entered into by the taxpayer within the District, or

(v) Solicits or promotes in the District sales of personal property by means of advertising, whether local or national, or solicits or promotes such sales by means of telephonic or telegraphic communication, or by correspondence with persons within the District, or

(vi) Enters into agreements, contracts, or arrangements, written or oral, with persons in the District by the terms of which such persons are required, authorized, or franchised, whether exclusively or otherwise, to purchase personal property from the taxpayer, whether or not such personal property is located within the District.

(b) SALES TO CUSTOMERS OUTSIDE THE DISTRICT.—There shall be included as a District sale a sale of tangible personal property to a customer outside the District where—

(i) a. The taxpayer is not engaged in a trade or business in the state, territory, possession of the United States, or other jurisdiction which is the place of delivery or ultimate destination of the personal property sold to the customer, and

b. The personal property sold by the taxpayer is located within the District, or

(ii) a. The taxpayer is engaged in a trade or business in a state, territory, possession of the United States, or other jurisdiction which is the place of delivery or ultimate destination of the personal property sold to the customer, and

b. The personal property sold by the taxpayer is located within the District, and

c. The income from the sale, if an income or franchise tax is imposed upon the taxpayer by such jurisdiction is not subject to inclusion in the measure of such tax.

(4) These amendments shall be applicable in any case in which the liability of the taxpayer to the District of Columbia for corporation or unincorporated business franchise tax under the District of Columbia Income and Franchise Tax Act of 1947, as amended, has not been finally determined for any year by a closing agreement or a compromise entered into pursuant to said Act, or by the application of a period of limitations prescribed in said Act, or by a decision of a court which has become final.

(5) If any provision of these amendments or the application thereof to any person or circumstances is held invalid, the remainder of these amendments, and the application thereof to other persons or circumstances, shall not be affected thereby."

5. STATE STATUTES:

a. Delaware Code, Title 30, Part II, Chapter 19, Secs. 1902, 1903:

§ 1902: Imposition of tax on corporations; exemptions.

(a) Every domestic or foreign corporation that is not exempt under subsection (b) of this section shall annually pay a tax of five per cent on its taxable income, computed in accordance with section 1903 of this title, which shall be deemed to be its net income derived from business activities carried on and property located within this State during the income year. Any receiver, referee, trustee, assignee or other fiduciary, or any officer or agent appointed by any court, who

conducts the business of any corporation, shall be subject to the tax imposed by this chapter in the same manner and to the same extent as if the business were conducted by the corporation.

(b) The following corporations shall be exempt from taxation under this chapter:

1. Fraternal beneficiary societies, orders or associations,

(A) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and

(B) providing for the payment of life, sick, accident, or other benefits to the members of such society, order or association, or their dependents;

2. Cemetery corporations and corporations organized or trusts created for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual;

3. Business leagues, chambers of commerce, fire companies, merchants' associations, or boards of trade not organized for profit, and no part of the net earnings of which inures to the benefit of any private stockholder or individual;

4. Civic leagues or organizations not organized for profit, but operated exclusively for the promotion of social welfare;

5. Clubs organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, not part of the net earnings of which inures to the benefit of any private stockholder or member;

6. A corporation maintaining a statutory corporate office in the State but not doing business within the State of Delaware;

7. Insurance companies paying taxes upon gross premiums to the Insurance Commissioner;

8. Corporations whose activities within this State are confined to the maintenance and management of their intangible investments and the collection and distribution of the income from such investments or from tangible property physically located outside this State. Added 51 Del. Laws, Ch. 298, eff. Dec. 20, 1957; amended 51 Del. Laws, Ch. 315, §§ 2, 3, eff. Feb. 5, 1958.

§ 1903. Computation of taxable income.

(a) The "entire net income" of a corporation for any income year means the amount of its federal taxable income for such year as computed for purposes of the federal income tax, adjusted by eliminating—

1. any deduction for the tax imposed by this chapter or for any net operating loss sustained prior to January 1, 1958;

2. dividends received on shares of stock or voting trust certificates;

3. interest income (including discount) other than interest on notes, bonds, accounts receivable, conditional or other sales contracts, or other instruments which evidence obligations to pay money, not regularly traded on a securities exchange or in an over-the-counter securities market, acquired in the regular and usual course of business by corporations engaged in the business of selling goods or services, lending money, financing the purchase of goods or purchasing commercial paper or evidences of indebtedness arising from the sale of goods or services;

provided that an obligation representing an advance or loan between corporations which are members of an affiliated group of corporations, as defined in section 1906 of this title, shall not be deemed to have been acquired in the course of the taxpayer's business, if the debtor corporation agrees to eliminate the interest paid thereon in determining its entire net income;

4. gains and losses from the sale or other disposition of stocks, securities, and other intangible assets not held primarily for sale to customers in the course of the corporation's business.

(b) "Taxable income" subject to taxation under this chapter means the portion of the entire net income of a corporation which is allocated and apportioned to this State in accordance with the following provisions:

1. Rents and royalties (less applicable or related expenses) from tangible property shall be allocated to the state in which the property is physically located.

2. Patent and copyright royalties (less applicable or related expenses) shall be allocated proportionately to the states in which the product or process protected by the patent is manufactured or used, or in which the publication protected by the copyright is produced or printed.

3. Gains and losses from the sale or other disposition of real property shall be allocated to the state in which the property is physically located.

4. Gains and losses from the sale or other disposition of tangible property for which an allowance for depreciation is permitted for federal income tax purposes shall be allocated to the state where the property is physically located or is normally used in the taxpayer's business.

5. Gains and losses from the sale or other disposition of intangible property, to the extent included in determining entire net income, shall be allocated to the commercial domicile of the corporation.

6. Interest (including discount), to the extent included in determining entire net income under subsection (a) of this section, less related or applicable expenses, shall be allocated to the state where the transaction took place which resulted in the creation of the obligation with respect to which the interest was earned.

7. If the entire business of the corporation is transacted or conducted within this State, the remainder of its entire net income shall be allocated to this State. If the business of the corporation is transacted or conducted in part without this State, such remainder shall be apportioned to this State on the basis of the ratio obtained by taking the arithmetical average of these three ratios:

(A) The average of the value, at the beginning and end of the income year, of all the real and tangible personal property, owned or rented, in this State by the taxpayer, expressed as a percentage of the average of the value, at the beginning and end of the income year, of all such property of the taxpayer both within and without this State, provided that any property, the income from which is separately allocated under paragraph 1 of this subsection, or which is not used in the taxpayer's business, shall be disregarded. For the purposes of this paragraph, property owned by the taxpayer shall be values at its original cost to the taxpayer, and property rented by the taxpayer shall be valued at eight times the annual rental;

(B) Wages, salaries and other compensation paid by the taxpayer to employees within this State, except general executive officers, during the income year expressed as a percentage of all such wages, salaries and other compensation paid within and without this State during the income year to all employees of the taxpayer, except general executive officers;

(C) Gross receipts from sales of tangible personal property physically delivered within this State to the purchaser or his agent (but not including delivery to the United States mail or to a common or contract carrier for shipment to a place outside this State, and gross income from other sources within this State for the income year expressed as a percentage of all such gross receipts from sales of tangible personal property and gross income from other sources both within and without the State for the income year; provided that any receipts or items of income that are excluded in determining the taxpayer's entire net income or are directly allocated under paragraphs 1 to 6 of this subsection shall be disregarded.

(c) If the allocation and apportionment provisions set forth in this section assign more than a fair and equitable proportion of the taxpayer's entire net income to this State, the Tax Commissioner, in his discretion may permit the exclusion of any one or more of the factors specified above, or the inclusion of one or more additional factors, or both; or the use of a separate accounting or of any other method necessary to produce a fair and equitable result.

(d) In determining the taxable income of a fiscal year taxpayer for that portion of its fiscal year ending within 1958 which falls within the calendar year 1958,

the taxpayer may at its election treat such period as though it were the entire fiscal year, or it may compute its taxable income for the entire fiscal year and pay the tax herein imposed on that portion of the taxable income so determined which the number of days from January 1, 1958 to the close of the fiscal year in 1958 bears to 365. Added 51 Del. Laws, Ch. 298, eff. Dec. 20, 1957; amended 51 Del. Laws, Ch. 315, § 4, eff. Feb. 5, 1958.

b. Maryland Annotated Code of 1957, Article 81, Secs. 288(e), 316:

"§ 288. Imposition of tax.

* * * *

"(e) Corporate tax for years subsequent to 1954.—There is hereby annually levied and imposed for each year beginning after December 31, 1954, a tax on the net income of every corporation (domestic or foreign) at the rate of four and one-half per cent (4½%) of such portion thereof as is allocable to this State under the provisions of § 316 hereof."

§ 316. Allocation of corporate income.

The net income of a corporation (domestic or foreign) shall be allocated in the following manner:

(a) *Income from real estate or tangible personal property.*—Income from ground rents, rents and royalties and other income from real estate or tangible personal property permanently located in this State (less related expenses) shall be allocated to this State; and such income from real estate or tangible personal property permanently located outside this State (less related expenses), shall be allocated outside this State.

(b) *Business income.*—The remaining net income, hereinafter referred to as business income, shall be allocated to this State if the trade or business of the corporation is carried on wholly within this State, but

if the trade or business of the corporation is carried on partly within and partly without this State so much of the business income of the corporation as is derived from or reasonably attributable to the trade or business of the corporation carried on within this State, shall be allocated to this State and any balance of the business income shall be allocated outside this State. The portion of the business income derived from or reasonably attributable to the trade or business carried on within this State may be determined by separate accounting where practicable, but never in the case of a unitary business; however, where separate accounting is neither allowable nor practicable the portion of the business income of the corporation allocable to this State shall be determined in accordance with a three-factor formula of property, payroll and sales, in which each factor shall be given equal weight and in which the property factor shall include rented as well as owned property and tangible personal property having a permanent situs within this State and used in the trade or business shall be included as well as real property. The Comptroller of the treasury shall have the right, in those cases where circumstances warrant, to alter any of the above rules as to the use of the separate accounting method or the formula method, the weight to be given the various factors in the formula, the manner of valuation of rented property included in the property factor and the determination of the extent to which tangible personal property is permanently located within the State. (An. Code 1951, § 312; 1939, § 253; 1939, ch. 277, § 246; 1941, ch. 912, § 253(b); 1951, ch. 597, § 253(b).)

c. Michigan, Act 150 of 1953, Secs. 2 and 3 (Compiled Laws, 1948, Secs. 205.552-553):

SEC. 2. There is hereby levied and imposed upon persons engaging in business in Michigan, a specific tax on income at the following rates:

(a) Two mills on the adjusted receipts of public utilities derived from or attributable to Michigan sources.

(b) Seven and three-quarters mills on the adjusted receipts of all taxpayers other than public utilities derived from or attributable to Michigan sources.

(c) The tax computed in the manner prescribed by this section shall be reduced in the percentage, not in excess of 25%, that 1% of the taxpayer's adjusted receipts bears to the net income of the taxpayer.

The adjusted receipts of a taxpayer derived from or attributable to Michigan sources shall be determined in accordance with the provisions of section 3 of this act.

(CL '48, § 205.552.)

SEC. 3. The adjusted receipts of a taxpayer derived from or attributable to Michigan sources shall be taken to be:

(a) In the case of adjusted receipts of a taxpayer whose business transactions take place entirely within this state, the entire adjusted receipts of such taxpayer;

(b) In the case of adjusted receipts of a taxpayer who conducts business transactions (other than transportation services) which take place partially within and partially without this state, the adjusted receipts of such taxpayer derived from or attributable to Michigan sources as shown by the formulae hereinafter provided in this subparagraph (b), or at the option of the taxpayer, by separate accounting methods acceptable to the department. Where the taxpayer shall so elect or where separate accounting does not properly and fairly indicate the adjusted receipts of the taxpayer derived from or attributable to Michigan sources:

(1) The adjusted receipts of such taxpayer derived from or attributable to Michigan sources shall be deemed to be that portion of the adjusted receipts of

the taxpayer obtained by applying the average of the following 3 percentages, separately computed:

A. The average value of the taxpayer's real and tangible personal property within the state during the period covered by its report, divided by the average value of all the taxpayer's real and tangible personal property wherever situated during such period: Provided, That such property value, both within Michigan and everywhere, shall include a sum equal to 8 times the gross rents paid or accrued per annum by the taxpayer during the period covered by the taxpayer's report for the use of real property: Provided, however, That the value of buildings erected on leased land by or on behalf of the lessee shall be included in the taxpayer's real property both within Michigan and everywhere in the same manner as if owned by the taxpayer. "Gross rents" shall include the entire amount of money or other consideration includable as an expense deduction in the taxpayer's annual statement of profit and loss for the period ending on the date of the taxpayer's report, either directly or indirectly, or for its benefit for the use or possession of real property irrespective of whether such rent be stated as a fixed sum of money, a percentage of sales, profits or otherwise, and shall include any amount paid or accrued as interest, taxes, insurance or any other item of expense to the taxpayer pursuant to its use of real property belonging to another, but shall not include depreciation or amortization on buildings erected on leased land by the taxpayer or amounts separately billed for utility service, whether billed by the lessor or another.

B. The total wages, salaries and other personal service compensation during such period, computed on the cash or accrual basis according to the method used for federal tax purposes, of officers and em-

ployees within the state divided by the total wages, salaries and other personal service compensation, similarly computed, during such period of all the taxpayer's officers and employees within and without the state.

C. The gross receipts of the taxpayer, similarly computed, arising during such period from:

1. Sales of its tangible personal property where deliveries or shipments are made to points within this state;

2. Services performed within this state;

3. Rentals from property situated within this state and royalties from the use of patents or copyrights within this state; divided by the total amount of the taxpayer's gross receipts, similarly computed, arising during such period from all sales of its tangible personal property, services performed, and rentals and royalties, both within and without the state. . . . CL '48, § 205.553.

APPENDIX C*

	1957			1958		
	Single Factor	Two Factor	Three Factor	Single Factor	Two Factor	Three Factor
	Destination Sales	(1) Gross Owned and Rented Property (2) Payroll	(1) Gross Owned and Rented Property (2) Payroll (3) Destination Sales	Destination Sales	(1) Gross Owned and Rented Property (2) Payroll	(1) Gross Owned and Rented Property (2) Payroll (3) Destination Sales
Apportionable Income	$1,312,092,839	$1,312,092,839	$1,312,092,839	$653,396,893	$653,396,893	$653,396,893
Apportionment Percentage	.3930%	.0348%	.1542%	.4144%	.0366%	.1625%
Apportioned Income	5,156,525	456,608	2,023,247	2,707,677	239,143	1,061,769
Income Directly Allocated	10,320	10,320	10,320	15,418	15,418	15,418
Taxable Income	$ 5,166,845	$ 466,928	$ 2,033,567	$ 2,723,095	$ 254,561	$ 1,077,187
Rate of Tax	.05	.05	.05	.05	.05	.05
Tax	$ 258,342.25	$ 23,346.40	$ 101,678.35	$ 136,154.75	$ 12,728.05	$ 53,859.35

Computation of Apportionment Percentage:

1. Gross Owned and Rented Property								
(a) In District—								
Gross Owned	$ 378,476				$ 347,025			
Rented (rent x 8)	982,200				979,184			
Total	$ 1,360,676				$ 1,326,209			
(b) Everywhere—								
Gross Owned	$6,146,870,978				$6,295,491,112			
Rented (rent x 8)	100,289,392				108,182,464			
Total	$6,247,160,370				$6,403,673,576			
Percentage (a) ÷ (b)	.0218%		.0218%	.0218%	.0207%		.0207%	.0207%
2. Payroll								
(a) In District	$ 1,268,180				$ 1,233,787			
(b) Everywhere	2,662,072,037				2,354,049,741			
Percentage (a) ÷ (b)	.0477%		.0477%	.0477%	.0524%		.0524%	.0524%
3. Sales								
(a) To District Customers	$ 37,185,704				$ 32,542,519			
(b) To All Customers	9,461,855,874				7,853,393,381			
Percentage (a) ÷ (b)	.3930%	.3930%		.3930%	.4144%	.4144%		.4144%
Total Percentages		.3930%	.0695%	.4625%		.4144%	.0731%	.4875%
Average Percentage		.3930%	.0348%	.1542%		.4144%	.0366%	.1625%

* Stipulated data (R. 372-5, 377-80, 385-7) and computations based thereon.

APPENDIX D

Comparison of Factual Situations in *Broadcasting Publications, Inc.* v. *District of Columbia*, 114 U.S. App. D.C. 163, 313 F. 2d 554, and in *General Motors Corporation* v. *District of Columbia*

	Broadcasting		General Motors
1. "Function which fairly reflects geographic sources of income . . . essence of the . . . business for franchise tax purposes"	"Publishing and distributing the magazine"		Manufacturing (and distributing?) automobiles
Activity	% in District		% in District
2. Publishing	100%		None
3. Distributing	100%	Manufacturing	None or de minimis
4. Sales			None
Circulation	100%		
Advertising	3%		
5. Solicitation		(Indirect)	None or de minimis
Subscribers (mail)	100%		
Advertisers	3%		
6. Receipt of orders			None
Circulation	100%		
Advertising	3%		
7. Acceptance of orders			None
Circulation	100%		
Advertising	3%		
8. Shipping (mail)	100%	(Common carrier)	None
9. Billing	100%		None
10. Receipt of payment	100%		None
11. Customer records	100%		None
12. Newsgathering	70%	Engineering, etc.	None
13. Principal offices	100%		None
14. Payroll	63%		.05%
15. Property	Principally		.02%
Other Factors			
16. Customers			.4%
Subscribers	4%		
Advertisers	3%		
17. "Significant daily business contacts" outside District	No*		Substantially all
18. Outside "business contacts . . . same kind as . . .principal" business inside District	No*		No

	Broadcasting		General Motors
1. "Function which fairly reflects geographic sources of income . . . essence of the . . . business for franchise tax purposes"	"Publishing and distributing the magazine"		Manufacturing (and distributing?) automobiles
Activity	**% in District**		**% in District**
2. Publishing	100%		None
3. Distributing	100%	Manufacturing	None or de minimis
4. Sales			None
Circulation	100%		
Advertising	3%		
5. Solicitation		(Indirect)	None or de minimis
Subscribers (mail)	100%		
Advertisers	3%		
6. Receipt of orders			None
Circulation	100%		
Advertising	3%		
7. Acceptance of orders			None
Circulation	100%		
Advertising	3%		
8. Shipping (mail)	100%	(Common carrier)	None
9. Billing	100%		None
10. Receipt of payment	100%		None
11. Customer records	100%		None
12. Newsgathering	70%	Engineering, etc.	None
13. Principal offices	100%		None
14. Payroll	63%		.05%
15. Property	Principally		.02%
Other Factors			
16. Customers			.4%
Subscribers	4%		
Advertisers	3%		
17. "Significant daily business contacts" outside District	No*		Substantially all
18. Outside "business contacts . . . same kind as . . . principal" business inside District	No*		No
Held	Entire income taxable in District.		Entire income from District sales taxable in District.

* Broadcasting had offices in three other states, but the Court of Appeals disregarded them.

APPENDIX E

Comparative Computation of Apportionment (Extract from Court of Appeals Brief)

Actually, that computation of net income, and the computations of the Tax Court under the apportionment formula which it used, are shorthand computations which produce accurate results but which tend to obscure what is being done. Working them in longhand helps to clarify.

The Act directs that net income shall be determined by subtracting from gross receipts the expenses and other deductions attributable thereto. (Art. I, Title III; Sec. 47-1557 to 47-1557b, D.C. Code, 1961.) We know the amounts of total gross receipts and the part thereof derived from sales to District customers. Applying that ratio to the known total expenses and other deductions, we determine the deductions allocable to District receipts. Subtracting one from the other leaves net income from that segment of the business represented by "District receipts." Thus, for 1957 (figures for convenience are in thousands of dollars and rounded) (App. *infra* 43a):

	Longhand Method	Shorthand Method
(a) District Receipts	37,186	37,186
(b) Total Receipts	9,461,856	9,461,856
(c) Total Deductions	8,149,763	
(d) Total Income		1,312,093
(e) Segment Deductions $(a \div b) \times c$	32,029	
(f) Segment Income $a - e$	5,157	
(g) Segment Income $(a \div b) \times d$		5,157

Either method arrives at the same amount of net income derived from the segment of the business carried on both within and without the District. That is the amount which is to be apportioned. Again, the apportionment can be done either longhand (for clarity) or shorthand (for

convenience). The Tax Court used shorthand, as does Respondent in its tabulation (App. *infra* 43a), and as is generally done. Here we illustrate both, again with 1957 figures, on the assumption, supported by the uncontradicted expert testimony, that "payroll" and "property" fractions are sound measures of relative business activity:

	Longhand Method	Shorthand Method
(a) District Recepits	37,186	
(b) Total Receipts	9,461,856	
(d) Total Income		1,312,093
(f) Segment Income	5,157	
(h) District Payroll	1,268	1,268
(i) Total Payroll	2,662,072	2,662,072
(j) Segment Payroll $(a \div b) \times i$	10,462	
(k) District Property	1,361	1,361
(l) Total Property	6,247,160	6,247,160
(m) Segment Property $(a \div b) \times l$	24,551	
(n) District Income $\frac{(h \div j) + (k \div m)}{2} \times f$	457	
(o) District Income $\frac{(h \div i) + (k \div l)}{2} \times d$		457

Longhand or shorthand, the result is the same; but the longhand method shows more clearly the illogic of using a sales factor, either alone or in conjunction with other factors, for "apportionment" purposes. When the ratio of gross receipts has been applied to determine the amount

of net income to be allocated to the selected segment, it has exhausted its function and cannot validly be used again to divide up that income. Nevertheless, there are practical reasons for a three-factor formula, including sales, as Respondent pointed out to the Tax Court, and as the Tax Court found. That feature can be added to the tabulation as follows:

	Longhand Method	Shorthand Method
(p) District Income $\frac{((h \div j) + (k \div m) \times f) + f}{3}$	2,023	
(q) District Income $\frac{(h \div i) + (k \div l) + (a \div b)}{3} \times d$		2,023

The longhand method clearly reveals the duplication in the treatment of income—that is, using the income to apportion itself. The effect is arbitrarily to assign or allocate one-third of the apportionable income to the District, and then to apportion the remaining two-thirds. The identical principle is involved in, and the identical result achieved by, the shorthand method. This last is the one used by the Tax Court, and the figure shown is the one arrived at by the Tax Court.

APPENDIX F

GENERAL MOTORS CORPORATION

1957 D.C. TAX LIABILITY USING FORMULAE OF OTHER STATES

	1 California Connecticut Maryland Minnesota	2 Delaware Georgia Michigan	3 Connecticut New York North Carolina	4 Texas	5 Ohio
Apportionable Income	1,312,092,839	1,312,092,839	1,312,092,839	1,312,092,839	1,312,092,839
Apportionment Percentage	.0253%	.1542%	.0218%	.0000%	.0109%
Apportioned Income	331,959	2,023,247	286,036	—0—	143,018
Income Directly Allocated	10,320	10,320	10,320	10,320	10,320
Taxable Income	342,279	2,033,567	296,356	10,320	153,338
Rate of Tax	.05	.05	.05	.05	.05
Tax	17,113.95	101,678.35	14,817.80	516.00	7,666.90
Computation of Apportionment Percentage					
1. Property					
(a) In District	1,360,676	1,360,676	1,360,676		1,360,676
(b) Everywhere	6,247,160,370	6,247,160,370	6,247,160,370		6,247,160,370
Percentage (a) ÷ (b)	.0218%	.0218%	.0218%		.0218%
2. Payroll					
(a) In District	1,268,180	1,268,180			
(b) Everywhere	2,662,072,037	2,662,072,037			
Percentage (a) ÷ (b)	.0477%	.0477%			
3. Sales					
(a) In District	600,859	37,185,704		—0—	—0—
(b) To All Customers	9,461,855,874	9,461,855,874		9,461,855,874	9,461,855,874
Percentage (a) ÷ (b)	.0064%	.3930%		.0000%	.0000%
Total Percentages	.0759%	.4625%	.0218%	.0000%	.0218%
Average Percentage	.0253%	.1542%	.0218%	.0000%	.0109%

Note: The computations above, in support of footnote 35 on p. 43, were made by applying the factors employed by the several states to figures related to petitioner's sales, income, property and payroll, as tabulated in Appendix C, *supra*. Column 1 reflects the California formula involved in *Butler Bros.* v. *McColgan;* the Connecticut formula in *Spector Motor Service v. O'Connor;* the Maryland formula in Appendix B, *supra;* and the Minnesota formula in *Northwestern States Portland Cement Co.* v. *Minnesota.* In column 2, the computations reflect the Delaware formula in Appendix B, *supra;* the Georgia formula in the *Stockham Valves* portion of *Northwestern States;* and the Michigan formula in Appendix B and in *Armco Steel Corp.* v. *Michigan.* In column 3, the formulae are those used in Connecticut, New York, and North Carolina, respectively, at the time of *Underwood Typewriter Co.* v. *Chamberlain; Bass, Ratcliff & Gretton* v. *State Tax Commission;* and *Hans Rees' Sons* v. *North Carolina.* In columns 4 and 5, the Texas and Ohio formulae involved in *Ford Motor Co.* v. *Beauchamp* and *International Harvester Co.* v. *Evatt,* respectively, although in fact applicable to the apportionment of *capital* values, have been applied for illustrative purposes to apportion petitioner's net income.

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BRIEF FOR RESPONDENT

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1964

No. 352

GENERAL MOTORS CORPORATION, *Petitioner*

v.

DISTRICT OF COLUMBIA, *Respondent*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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IN THE

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OCTOBER TERM, 1964

No. 352

GENERAL MOTORS CORPORATION, *Petitioner*

v.

DISTRICT OF COLUMBIA, *Respondent*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR RESPONDENT

Questions Presented*

In the view of respondent, the questions presented are:

Where the Congress acting under its plenary power over the District of Columbia provided, in the District of Columbia Income and Franchise Tax Act of 1947, for the imposition of a franchise tax upon corporations engaged in trade or business in the District of Columbia to be measured by "that portion of the net income of the corporation and unincorporated business as is fairly attributable to any trade or business carried on or engaged in within the District and such other net income as is derived from sources within the District," and where, pursuant to the act, the

*As stated by respondent in its Brief in Opposition to Petition for Writ of Certiorari.

Commissioners of the District adopted regulations containing a formula for the apportionment of the income of corporations engaged in the District and elsewhere in selling personal property on the basis of the ratio which such sales in the District by the corporation bear to its sales everywhere, and where this method of apportionment was applied by the District to General Motors Corporation, was not the United States Court of Appeals for the District of Columbia Circuit, sitting en banc, correct in holding:

1. That the apportionment formula prescribed in the Commissioners' regulations for apportioning net income, is a valid formula under the District of Columbia Income and Franchise Tax Act of 1947 and, as such, applicable to General Motors Corporation?

2. That the Commissioners' apportionment formula is not violative of or in conflict with the Constitution or decisions of this Court, and that its application to petitioner does not apportion to the District of Columbia net income in excess of that attributable to petitioner's activities within the District?

Counter-Statement of The Case

As will be evident by reference to the stipulations of fact and the majority opinion of the United States Court of Appeals for the District of Columbia Circuit on rehearing en banc (R. 260-436, 498-527), General Motors' statement of the case in its brief (pp. 4-9) contains only the barest outline of the nature and extent of its multi-faceted business operations within the District of Columbia. For this reason, respondent deems it essential to set forth the pertinent facts.

At the outset of their stipulation the parties stated that "Petitioner's [General Motors] methods of doing business and selling and distributing its products as described [in

the stipulation] are the same throughout the country." (R. 261.)

In addition to its central management staffs, General Motors is organized into a number of divisions, which are not separately incorporated, and which operate substantially independently of one another. The divisions are concerned with the manufacture, assembly, and/or sale of one or more of the Company's products. General Motors' principal business is the manufacture and sale of automobiles, trucks, other vehicles, parts and accessories. (R. 261.)

General Motors' Car Divisions consist of Pontiac Motor Division, Chevrolet Motor Division, Buick Motor Division, Oldsmobile Division, and Cadillac Motor Car Division, each of which, with the exception of Cadillac, has substantially identical operations throughout the country. (R. 262, 269, 268, 273.) The activities of these divisions, both within and without the District, are as follows:

For administrative purposes the country is divided into a number of "regions", each of which is subdivided into a number of "zones." (R. 261, 262.) With minor exceptions, each of the divisions sold its products only to authorized General Motors' dealers. (R. 284.) Dealer contracts contained explicit and detailed terms and conditions governing the responsibilities of the dealers. Typical of the dealer contracts was that used by Chevrolet (R. 307-331), the first paragraph of which states:

> "FIRST: Subject to the terms and conditions hereof, Chevrolet will sell and Dealer will buy Chevrolet motor vehicles and chassis with Dealer having the obligation to develop properly the sale thereof at retail particularly in the following area: * * *" (R. 310.)

A separate document, entitled "Terms and Conditions," was incorporated in and made a part of the selling agreement. Among its requirements were the following:

1. The dealer shall furnish Chevrolet every month an estimate of his requirements for the next three calendar months of new motor vehicles and chassis.

2. The dealer shall furnish every ten days a report showing retail sales of both new and used cars during that period, new and used car stocks, and unfilled orders on hand at the end of the period.

3. The dealer shall submit, on order forms supplied by Chevrolet, orders for Chevrolet's products for acceptance at mutually-satisfactory periods, and pay Chevrolet therefor the "dealer's price established by Chevrolet," and in effect at the time of shipment, plus a factory handling charge determined by Chevrolet, including reimbursement for any tax which Chevrolet paid, incurred or agreed to pay on such vehicles or chassis, on terms of cash, sight draft, or sight draft with bill of lading attached, plus collection charges. Dealers pay interest on all drafts from the dates specified thereon.

4. Chevrolet selects the distribution point and mode of transportation for vehicles shipped to a dealer, and prepays all charges including transportation charges. The dealer pays Chevrolet the distribution charges established by the division with the right reserved in Chevrolet to change its charges at any time. All claims for loss or damage to merchandise while in the custody of the transporter must be submitted by the dealer to Chevrolet within twenty days after date of delivery.

5. The dealer has the right to sell new parts and accessories, acquired by him at prices, terms and provisions established by Chevrolet, either directly from, or through a parts warehouse designated by Chevrolet.

6. The dealer must maintain a place of business satisfactory to Chevrolet as to appearance, location, and adequacy in size and layout, which place may not be moved,

nor a new or different location established, without prior written approval of Chevrolet.

7. The dealer must maintain his capital and net worth in the amounts and form specified by Chevrolet and, after negotiating with Chevrolet, revise such amounts to meet, within the negotiated time, changed conditions.

8. The dealer must maintain a uniform accounting system prescribed by Chevrolet; permit examination by Chevrolet's personnel of his accounts and records; provide satisfactory sales performance and service to owners in the dealer's operating area; maintain satisfactory sales performance in relation to competitive products, and in comparison with competitive Chevrolet dealers in the area; maintain an adequate staff of salesmen, and selling and customer relations organization; maintain complete, current records of sales and servicing of Chevrolet products; provide adequate customer complaint service, and maintain an adequate number and assortment of parts and accessories, and an adequate staff of mechanics for service.

9. Chevrolet may terminate the agreement for failure of the dealer to accord with any of the contract requirements and on other stated grounds, with detailed provisions concerning the effect of termination. Also contained are provisions concerning termination by the dealer. (R. 312-31.)

During the years 1957 and 1958, Pontiac Division had four dealers in the District, Oldsmobile had five, Buick had four, Chevrolet Motor Division had five, and Cadillac Motor Division had a distributor in the District who was also a retail dealer. (R. 268-69, 272-73.) The Chevrolet Division maintained a regional office in the District and a zone office in Baltimore, Maryland. (R. 270, 381.) Although the regional and zone offices of the remaining divisions were outside the District, zone offices in each case

were located within the Washington Metropolitan Area, from which offices the District activities of the divisions were conducted. As described in respect of the Chevrolet division, the operations of a regional office are as follows:

It is responsible for supervision of a number of zones, and has a regional manager, various department heads, and clerical assistants. Dealer orders for cars go directly to zone offices. The regional office receives from the zone offices periodic sales reports which it consolidates and forwards to the division's headquarters. When the supply of vehicles is short, the regional office receives statements from division headquarters of regional allotments of vehicles which it allots among the regional zones. They, in turn, allocate the vehicles among zone dealers. Attached to Chevrolet's regional office in the District was a fleet manager, responsible for contacting local and national fleet users, supplying to them information and promoting fleet orders for vehicles to be placed by such users with dealers. The fleet manager spent in these activities in the District approximately 40 per centum of his time. Fleet orders derive from large commercial users, municipalities and states. The fleet manager assists dealers in preparation of bids and specifications, and advises fleet users on types of equipment suiting their requirements. Chevrolet makes fleet sales directly to its dealers who, in turn, resell them to fleet users. (R. 270-71.)

Zone managers for the car divisions, Pontiac's being typical, carry out a number of activities connected with the division's commercial activities. The zone office was headed by a zone manager in charge of the overall office activity and the zone territory. His assistant spent approximately half of his time contacting zone dealers. His primary responsibility was supervision of district managers. The zone had a business management manager and a parts and services

manager, most of their time being spent visiting dealers. It also had an office manager in charge of car distribution, an assistant office manager, a claims administrator who, with an assistant, was responsible for warranty adjustments, and three service representatives whose full time was spent visiting the dealers' parts and service departments. A school instructor was responsible for the training school maintained by General Motors at Fairfax, Virginia. Four district managers spent their entire time visiting dealers. The office was also provided with the usual clerks, stenographers and similar personnel.

The zone manager and his assistant periodically visited dealers in the District of Columbia and elsewhere in the zone "(1) to work with the dealers concerning market opportunities, (2) to promote the sale of promotional literature, and (3) to maintain dealer interest in items that will help the retail sale of automobiles. The district managers are primarily responsible for the foregoing activities, but are supported by the zone manager, the assistant zone manager, and * * * the zone department heads." (R. 263.) The primary duty of the business management manager was "to assist Pontiac dealers within the zone territory in making their operations more profitable. This is done by the suggestion of ideas which strengthen dealer business. It is also his duty to analyze dealer business procedures and activities." (R. 263.)

The office manager and his assistant processed orders from dealers and called specific dealers in regard thereto.

The zone parts and service manager made recommendations to dealers concerning their service facilities, and promoted the best service possible for new and used automobiles. He also maintained a check on dealers' supplies of parts, made suggestions to them for promotional activities in the service field and, where necessary, recommended increases in a dealer's parts supply. The manager proc-

essed complaints from retail customers, and determined whether dealers satisfied customer warranty obligations.

The zone claims administrator, and his assistant, processed dealers' claims under General Motors' express warranties to dealers. These officials also processed complaints from retail customers. The three zone office service representatives functioned in a manner comparable to the zone parts and service manager. The district manager continually visited dealers in the District of Columbia, urging the ordering by them of promotional materials and special tools orders which, though obtained from other manufacturers, were billed to Pontiac and rebilled to the dealers at cost. The district manager solicited from dealers orders to round out their inventories of parts and accessories. He received dealers' orders, although most of them were sent directly to General Motors' parts division warehouse in Baltimore, Maryland.

The district manager assisted dealers in holding salesmen's meetings, discussed with the dealer's sales manager "business-getting methods" and "such matters as sales department organization, advertising, demonstrations, and salesmen's incentives. He advises on the reconditioning of, allowances for, and inventory of used cars. He tries to assist the dealers in maintaining proper inventories of new automobiles, neither too large nor too small." (R. 265.) Immediately before the introduction of new models, the district manager sometimes was required to urge dealers to purchase additional cars to maintain adequate stocks during the model change-over period. He informed dealers on models more salable than those in the dealers' existing stock. Monthly, he obtained from dealers within the District of Columbia, projections for the next three months of their new automobile requirements, to be used by the division for production planning purposes. From time to time, he would pick up for processing through the zone office, or-

ders for new automobiles, although most orders were sent by the dealers directly to the latter office. The zone office also maintained a small stock of automobiles which it sold directly to dealers. (R. 265-66.)

The "90-Day" projection requirements, the "10-Day" reports of sales and inventories, and the monthly financial statements of dealers were designed to aid the zone and, through consolidation, the national headquarters in Michigan, to plan production schedules for vehicles. Each dealer's financial statements were analyzed by zone business management managers and the zone manager to determine the financial condition of the dealer, and to ascertain whether weaknesses existed in his operations when compared with dealer averages. If so, the district manager discussed it with the dealer involved. More serious cases were handled by the zone manager and the business management manager. "The district manager, armed with the knowledge of dealer averages, gives the dealer advice and assistance on almost every phase of his business." (R. 267.)

Regular visits to the zone were made by the division's general manager, general sales manager, the division's assistant general sales manager and its regional manager. From time to time a department head from the sales staff in Michigan would visit the zone for the purpose of making good will calls on individual dealers and attending dealer division meetings conducted either in the District of Columbia or in Fairfax, Virginia. Of approximately ten dealer meetings a year, one or two included all dealers in the zone. They were held in the District of Columbia for the general purpose of a description by division personnel of new products, new sales promotion materials, and other matters. Annually, at an automobile show held in the District, zone personnel of the zone actively participated in organizing and setting up dealer displays, supplying to

them for this purpose automobiles which were thereafter sold to them. Zone personnel attended the show at all times to explain and describe General Motors' exhibits. (R. 267-68.)

The consequence of the activities of General Motors' employees was stipulated to be as follows:

> "(R) The assistance and advice provided to dealers, and the other activities as above described are a form of sales promotion to aid in attracting retail customers into the dealerships and in obtaining retail sales, and as a result of such retail sales, the wholesale orders from dealers to Petitioner [General Motors Corporation] flow automatically and are not ordinarily specifically solicited." (R. 268.)

Cadillac Motor Car Division operated differently than other divisions. Its products were merchandised principally through independently-owned distributors who, in turn, appointed dealers and performed functions substantially the same as those performed by the zone offices of the other car divisions. Each distributor had a "distributor selling agreement" with Cadillac and each was also a retail dealer. (R. 273.) Employees of this division, known as "district managers" and "district parts and service managers," maintained distributor and dealer contacts. The district manager for the "Washington Division", which included the District of Columbia, was located in the District of Columbia. In furtherance of his basic function to assist distributors and, through them, the dealers, in efficient operation, the district manager continually made calls on the distributors within the division. (R. 273-75.) He also consulted with the distributor concerning dealer activities, particularly relative to obtaining a share of the market; reviewed financial statements of distributors and dealers to aid them in their business operations, and participated in sales meetings. Distributors and dealers were

urged by Cadillac to have salesmen and mechanics attend General Motors' training center classes in Fairfax, Virginia. The parts and service manager, operating under the direction of the district manager, consulted with distributors and dealers on warranty claims, customer complaints, and other service matters, urging distributors and dealers to maintain adequate and current inventories of parts and accessories. (R. 276-77.)

General Motors Truck and Coach Division like the car divisions other than Cadillac operated through a system of "regions" and "zones". It appointed dealers for its products, one of which was located in the District of Columbia. (R. 277-78.) Zone personnel consisted of a zone manager, district managers, heavy duty truck managers, service representatives, a training school instructor, a zone service manager, a truck distributor with an assistant, and general office personnel. Their functions were typically the same as those of similar personnel in the car divisions and were directed to the promotion of the sale of the division's products, assisting dealers in their operations, dissemination of promotional material and promotional advice to dealers, and soliciting and promoting the sale of coach and coach parts to customers within the District of Columbia and elsewhere within the zone. As was the case with the car division, dealer meetings, conducted by the division for the purpose of familiarizing the dealer's salesmen with production information and suggestions for enhancing sales, were held in the District of Columbia and in Fairfax, Virginia. (R. 278-82.)

United Motors Service Division distributed at wholesale parts and accessories manufactured by General Motors and used in connection with its products. It dealt with wholesalers of automotive replacement parts, seventeen of whom were in the District of Columbia, under contract with General Motors. (For contract, see R. 334.) It oper-

ated through zones headed by a zone manager. A zone was in turn divided into districts headed by a district manager. In 1957 and for half of 1958, the zone office for the zone, which included the District of Columbia, was located in the District. Its purposes were to sell merchandise and, in general, to promote the sale of the division's products, and this function was carried out by the district manager and the zone merchandising representatives. (R. 294-96.) The zone service manager handled service problems with manufacturers, users, and distributors, and assisted wholesalers and retailers in settling users' complaints. He also encouraged wholesalers to send their salesmen and service personnel to General Motors' training center at Fairfax, Virginia. In addition to his general zone supervisory functions, the zone manager investigated potential new wholesalers and determined their reliability for appointment. (R. 296.)

AC Spark Plug Division manufactures automotive parts, such as spark plugs, oil filters and elements, fuel pumps, and other items, which it sells to warehouse distributors under contract with General Motors Corporation (R. 338-46), and to such national accounts as oil and tire companies which wholesale automotive replacement parts. It also manufactures defense type items. (R. 296-97.)

During the years involved, the division maintained an office within the District of Columbia staffed by a manager, a sales engineer, and two stenographers. This office maintained liaison with military and civilian agencies and with primary contractors concerned with defense materials manufactured by the division, and maintained liaison activities relating to planning by various government agencies. It advised the division of necessary engineering to be undertaken. It also informed government agencies of the capabilities of the division in respect to the manufacture of defense materials. (R. 287-88.)

In connection with the manufacture of automotive parts, (civilian sales), the division was organized into regional offices headed by a regional manager and staffed by zone managers, a fleet sales and service representative, national accounts representatives, a national account territory manager, a number of territory managers, and dealer merchandisers and clerical personnel. The zone manager, who resided in Maryland, but whose territory included the District of Columbia, trained and supervised five territory managers and five dealer merchandisers. One territory manager and one dealer merchandiser were assigned to the District of Columbia area. The zone and territory managers and dealer merchandisers spent almost all their time contacting distributors, of which in 1957 and 1958, there were six in the District of Columbia, plus two branch outlets of a Philadelphia warehouse distributor and one branch outlet of a Baltimore warehouse distributor. (R. 298, 300.)

The territory manager worked with distributors, promoted sales of the division's products, conducted sales meetings for warehouse distributor salesmen and set up displays and merchandising programs. Through personal contact he promoted the sale of the division's products to large fleet users and solicited and accepted orders from businesses such as service stations, garages and laundries, all of which used or dealt in the division's products. (R. 298-99.) Dealer merchandisers solicited and prepared orders for parts from service stations, garages, laundries, and other businesses, placing the orders with the jobber or warehouse distributor of the buyer's choice. Business calls within the District were made by the regional manager and the division's Eastern sales manager, as well as by the division's service representative, national accounts representative, and fleet sales and service representative. (R. 300.)

The Government Sales Section of General Motors Corporation's Central Office, headquartered in Detroit, obtained, received, and serviced invitations to bid on requirements of all federal government agencies for standard passenger cars and trucks. It also conducted liaison activities relating to procurement of special military vehicles for the armed services. In 1957 and 1958 the Government Sales Section maintained an office in the District of Columbia staffed by two contact men and four clerical type personnel. (R. 285.) The contact men called on procurement agencies to ascertain the agencies' plans for the purchase of vehicles, and to assure that the Detroit office was included among those to whom bid invitations were sent. Personnel contacted by the Section's employees in the District were located both within and without the District. The director of the Section spent approximately half his time in the District of Columbia discussing with government officials procurement of standard motor vehicles, contracts for which were executed by General Motors Corporation in Michigan and for the United States by General Services Administration in the District of Columbia. Armed Services contracts are executed both by the government and by General Motors in Detroit, Michigan. (R. 285-86.)

Automobiles and trucks purchased from Chevrolet for use in the District of Columbia were generally shipped from its Baltimore factory. The Cadillac Division rented to the White House and to other top level offices in the District of Columbia approximately 31 automobiles, supplying in certain cases service for the vehicles. (R. 286.)

General Motors' Allison Division, headquartered in Indiana, manufactures commercial aircraft engines, truck transmissions, heavy duty vehicles and rail cars, gas turbine engines, and defense items such as aircraft propellers and tank transmissions. In 1957 and 1958 it maintained

in the District of Columbia an office whose personnel contacted federal government and prime contractors in connection with the sales of defense materials. Three of its field engineers obtained information leading to the receipt by Allison of competitive business from the armed services or prime contractors. They also ascertained Armed Services needs so that division headquarters might study the feasibility of manufacturing needed items and assist prime contractors with development of items usable in carrying out their government contracts. (R. 289.)

In addition, personnel in the District of Columbia were involved with commercial projects, such as the sale to the Federal Aeronautics Administration of the Allison conversion of Convair airplanes and the sale of engines to commercial plane manufacturers. Division engineering personnel made regular monthly visits to the District to discuss technical details with government agencies or prime contractors, and members of the sales staff made frequent visits to discuss delivery schedules and costs of General Motors' products. (R. 290.)

The Cleveland Diesel Engine Division of General Motors, with headquarters and plant in Cleveland, Ohio, principally produces diesel engines and gas and dual fuel engines, and the like. (R. 291.) In 1957 and 1958, it maintained an office in the District of Columbia staffed by a manager who contacted various government agencies, both within and without the District of Columbia, to discuss and handle in general the division's quotations of prices to, and business with, the government, including negotiating details of contracts. After a General Motors' bid for a division product is delivered to the manager for transmittal to a government agency, he negotiates details of the contract with respect to particular clauses and works out changes in the bid, if required. He is active during the negotiation period of the contract, although after the contract has been con-

summated, he is not often further involved. (R. 291-92.)

Detroit Diesel Engine Division of General Motors, headquartered in Detroit, Michigan, manufactures diesel engines and certain items used for defense purposes. During 1957 and 1958 it maintained an office in the District of Columbia staffed by a manager and his secretary, together with a part-time consultant. This office maintained contact with various offices of the United States Government relating to the procurement of diesel engines and other division products. Its personnel in the District traveled to various government installations "looking for leads to applications for which Detroit Diesel engines may be recommended. The government requirements may originate anywhere, but most of them are 'coordinated' through the Washington headquarters of the government service involved." (R. 293.) The District of Columbia branch office attempted to have the government specify the use of Detroit Diesel engines or to draft specifications which the division could meet. Information thereon was forwarded by it to District headquarters in Detroit "to apprise it on the opportunity to sell the engines to the vehicle manufacturers." (R. 293.) It also worked in the District of Columbia with such agencies as the Bureau of Public Roads and governmental organizations involved in foreign assistance programs "to have specifications so developed that Foreign Distributors Division can bid for the use of Detroit Diesel engines, or so that a domestic vehicle manufacturer is able to meet specifications with a product which includes Detroit Diesel engines." (R. 293.)

Motors Holding Division of General Motors Corporation, headquartered in Detroit, Michigan, had its branch territory office in the District of Columbia during 1957 and 1958. It provided financing for new dealerships or those in the process of reorganization or expansion. (R. 302-03, 347-71.) If, after investigation and analysis, it was determined by

the branch manager that the applicant for financing was acceptable, and the transaction had been approved by the Division's investment committee in Detroit, the applicant received, for the 25 per cent minimum of the total capital he provided, non-voting stock in a corporation organized for the purpose. The Division provided the balance of the financing, half for voting stock and half for interest-bearing notes. During the entire time that the Division has an investment in the operation, it holds all the voting stock and nominates a majority of the directors of the business. Continuous control over the operation, and review of the soundness thereof, is exercised by Motors Holding Division.

During the period of financing, the Division's accounting supervisor periodically checks records of the business, and the branch manager, who is a director of the corporation, visits the dealership and attends directors' and stockholders' meetings. The dealer, who is subject to the control of the Division, operates the business but, pursuant to a planned formula geared to operating results, is required to buy from Motors Holding its interest in the dealership. (R. 303-04.)

During the years 1957 and 1958, four dealers in the District of Columbia were financed and controlled by Motors Holding Division. (R. 304.)

General Motors Overseas Operations Division which, during 1957 and 1958, maintained an office in the District of Columbia, contacted government agencies and foreign governments in the District of Columbia and elsewhere with respect to goods to be delivered abroad by General Motors, contracts therefor being negotiated in New York. The essential procedures of the District of Columbia office were the expediting of the Division's activities, and the obtaining of information from governmental agencies in the District and elsewhere in connection with agency regulatory activities as they affected sales of and services for equipment

shipped by General Motors outside of the United States, particularly in connection with the function of the agencies in procurement on behalf of foreign recipients of international aid. The District of Columbia office was also used as the contact office through which government agencies could expedite their orders for General Motors' products. In addition, it had a public relations function consisting of the distribution of press releases, the gathering of information, and the exchange of information with various trade associations located in the District. (R. 301-02.)

The Business Research Staff of General Motors, headquartered in Detroit, maintained during 1957 and 1958 a District of Columbia office. The Staff has as its function, economic and statistical research for the purpose of forecasting general economic conditions and their effect on products and potential product changes to be developed and manufactured by General Motors. The District of Columbia office gathered information from governmental offices in the District and elsewhere and from private agencies, and supplied to governmental agencies information they requested or required. Some contact was also maintained by it with regulatory bureaus concerned with matters affecting General Motors and with professional staffs of Congressional committees. (R. 300-01.)

General Motors Patent Section, headquartered in Detroit, maintained a branch office in the District of Columbia to which were assigned approximately fifteen men, most of whom were graduate engineers, together with five clerical personnel. The primary function of this office was to conduct in the Patent Office patent and trade-mark investigations. It also filed patent, trade-mark and copyright applications, did detailed work in connection with cases pending before the Court of Customs and Patent Appeals, the Court of Claims, and the Patent Office, and interviewed examiners in the Patent Office in connection with the allowance of claims. (R. 304-05.)

The Public Relations Staff of General Motors, also headquartered in Detroit, maintained an office in the District of Columbia to maintain contacts with, and distribute to the District of Columbia press and magazine corps and other communications media, such as radio and television, releases of General Motors and to answer questions thereon. In addition, information relating to activities of government agencies, of interest to General Motors Corporation, was obtained. The District of Columbia office was the initial contact point for visits to General Motors' plants by government personnel, local personnel, communications industries personnel, and by other persons, and contact was also maintained by the office with trade associations headquartered in the District of Columbia. The primary purpose of the public relations staff office in the District was to serve as a "listening post and for rendering service to visiting General Motors executives." (R. 305-06.)

For promoting sales of the corporation's products, General Motors' estimated expenditures for national and local advertising of all kinds, including advertising through magazines, newspapers, radio and television, having a circulation in or directed to or emanating within the District of Columbia, aggregated in the year 1957, $144,000,00.00, and in the year 1958, 137,000,000.00. (R. 283-84.)

During the course of the trial before the Tax Court, petitioner produced four economists to state their views on the propriety, from an economic standpoint, of the application to General Motors of the District's apportionment formula. Each of these economists stated that the formula to be used should consist of the factors of capital investment (property) and labor (payroll) or costs. On the matter of the inclusion of sales as a factor in the formula, one of the economists stated unequivocally that he would allow only for the factors of property and payroll, without consideration to sales. Although not subscribing to a three-factor formula which would include sales as one of the factors

(since in their view as economists income is produced only by capital and labor), petitioner's remaining witnesses were substantially in agreement that a three-factor formula which includes sales as one of the elements would not be particularly objectionable because sales, in some way or other, might reflect costs. Thus, there was disagreement among petitioner's own witnesses concerning a proper formula. (R. 39-47, 66-67, 76-77, 83-85, 93-95, 99, 102, 104.)

Three expert economists testified for the District. Contrary to the testimony of petitioner's witnesses, the District's experts were in complete agreement that the District's apportionment formula is entirely reasonable and provides an appropriate formula for the purpose of apportioning General Motors' net income. These witnesses were further of the opinion that a two-factor formula consisting of capital and labor, or a three-factor formula consisting of capital, labor, and sales, would not result in a more reasonable apportionment and, in fact, might well result in an improper apportionment for tax purposes of General Motors' income. (R. 127-31, 163-70, 189-99.)

The District of Columbia Tax Court made no findings concerning the testimony of the expert witnesses, saying that the witnesses for both parties were in error concerning a proper formula for the apportionment of income. (R. 453.)

In the year 1957, petitioner's sales to all of its customers amounted to $9,461,855,874, of which $37,185,704 derived from sales to District customers. The total net income of petitioner, subject to apportionment, amounted to $1,312,092,839. Applying to the total net income the District's apportionment formula, the net income apportioned to the District for 1957 amounted to $5,156,525, less than four-tenths of one per cent of petitioner's total net income.

In 1958, petitioner's total sales to all of its customers were $7,853,393,381, of which $32,542,519 derived from sales to District Customers. The total net income for that year,

subject to apportionment, was $653,396,893, and the amount apportioned to the District, employing the District's formula, was $2,707,677, slightly more than four-tenths of one per cent of the net income subject to apportionment. (R. 372-75.)

The Tax Court declined to sustain the District's determination of General Motors' franchise tax liability for the years 1957 and 1958, holding that the District's formula, as applied to General Motors, was not authorized by the statute. That court devised a new and different formula consisting, not of the two factors of property and payroll, for which petitioner's economists had testified, but of three factors of property, payroll, and sales, equally weighted. (R. 456-63.) On the basis of its formula, the Tax Court revised the District's assessments, ordering a refund to be made to General Motors of the difference. (R. 473.) The District appealed the decisions of the Tax Court to the United States Court of Appeals for the District of Columbia Circuit and a division of that court on February 21, 1963, affirmed the Tax Court, one judge dissenting. Thereafter, on rehearing en banc, the entire court, four judges dissenting, reversed the Tax Court, holding that the District's apportionment formula is in all respects valid and applicable to General Motors Corporation. (R. 498-532.)

Summary of Argument

The District of Columbia Income and Franchise Tax Act of 1947 expressly authorizes and directs the Commissioners of the District of Columbia to promulgate by regulation an apportionment formula for the purpose of determining what portion of the total net income of corporations, such as General Motors, is subject to District franchise tax. The legislative history of the 1947 Act, and its 1948 amendments, and the specific provisions of the Act itself,

show that Congress clearly intended that the income a corporation engaged in trade or business within the District derives from the sale of personal property to customers within the District is to be subject to franchise tax. That income has its source in the District, as well as its derivation from "trade or business" activities. The regulation of the Commissioners prescribing a formula for apportionment of the net income of taxable corporations is consistent with the statutory requirements, and with the Congressional intent.

Contrary to the contentions of General Motors, since the Commerce Clause of the Constitution does not limit the power of the Congress over the District in tax matters, that Clause cannot limit the authority of the Commissioners under the Act, particularly where, in pursuance of the requirements of the Act, the Commissioners have promulgated regulations in accord with it. Certainly, the Due Process Clause of the Fifth Amendment to the Constitution is inapplicable where, as here, the authority of the Congress to legislate for the District is unquestioned, and the validity of the taxing statute is conceded.

General Motors does not question its liability to the District for franchise taxes; it contends only that it was taxed too much. The volume of its business within the District, and the varied and extensive activities it conducts there, demonstrate that the District's apportionment formula did not ascribe to the District more of General Motors' net income than was fairly attributable to its local trade or business. Moreover, General Motors presented no evidence from which it could be determined that the District's tax was unfair, or disproportionate to the actual amount of net income which General Motors obtained through its District activities and from District sources. Nor did the Tax Court make any "factual finding" to that effect. The "findings" of that court on the impropriety of applying

the District's apportionment formula to General Motors are not findings of fact, but merely conclusions, unsupported in the record and rejected by the United States Court of Appeals for the District of Columbia Circuit.

General Motors relies upon testimony of economists to sustain its argument as to the invalidity of the District's apportionment formula. But the testimony of its economists, as well as the testimony of economists for the District, was completely disregarded by the Tax Court, which rejected the testimony on the ground, as it said, that all of the economists were in error. Even if the statements of the economists are considered, the record shows that they were in disagreement. In the absence of a clear showing by General Motors to the contrary, the validity of the District's formula remains unimpaired. Particularly is this so when General Motors made no attempt to prove what its net income from the District actually was, relying almost entirely upon the premise that a different formula would produce as to it a different tax result.

General Motors failed to sustain through competent evidence the contention it makes here that it was subjected by the District to "double taxation." Even if there was "double taxation", General Motors presented no evidence of the amount thereof. The District's tax is not to be invalidated merely because General Motors contends that, to some indeterminate degree, a portion of its income was subjected to tax by another taxing jurisdiction.

Argument

I

The District's regulation for the apportionment of net income is consistent with, if not required by, the District of Columbia Income and Franchise Tax Act of 1947.

General Motors contends at the outset that the assessments against it of District of Columbia corporation franchise taxes are contrary to the statute. It concedes, however, that the statute itself is entirely proper.[1] The proposition thus advanced by General Motors is that the Commissioners' regulation on the apportionment of the net income of a corporation, such as General Motors, produced, when applied to it, an overstatement of the net income which could be said to be "fairly attributable" to General Motors' "trade or business carried on or engaged in within the District."

The regulation under attack provides, in pertinent part:

> "(a) Where income for any taxable year is derived from the manufacture and sale or purchase and sale of tangible personal property, the portion thereof to be apportioned to the District shall be such percentage of the total of such income as the District sales made during such taxable year bear to the total sales made everywhere during such taxable year. * * * For the purpose of this regulation, the phrase 'District sales' shall mean all sales to District customers the income from which is fairly attributable to the trade or business carried on or engaged in within the District, including solicitation in the District by salesmen or other representatives of the taxpayer, that portion of sales to customers outside the District the income from which is fairly at-

[1] Petitioner's Brief pp. 12-13.

> tributable to the trade or business carried on in the District, and sales of tangible personal property the income from which is from District sources."[2]

Since the statute does not prescribe a formula for the apportionment of income and leaves this matter to the discretion of the Commissioners, the regulation which General Motors attacks can be invalid only if it is unconstitutional or is completely beyond the scope and intent of the taxing statute, producing upon its application to a taxpayer a result beyond the permissible limits which the Congress intended. Since General Motors concedes the validity of the taxing statute, the regulation is objectionable as to it only upon a clear demonstration, not that another method might or would have produced a different or more acceptable result, but that the portion of General Motors' total net income against which the statutory tax rate was applied was so disproportionate compared with the amount of that income which could be said to be "fairly attributable" to the totality of General Motor's activities in the District as to result in a tax beyond the statutory contemplation. The assertion by General Motors that the regulation effected the payment by it of a tax beyond the concept of the statute, and that the regulation is inherently improper, finds no support in the opinion of the majority of the Court of Appeals; neither does it find support in other decisions of the United States Court of Appeals for the District of Columbia Circuit which, over a period of many years, has reviewed the District's regulations on apportionment.

In the opinion on rehearing en banc it was said:

> "Having found that the single-factor sales formula employed by the District is permitted by the District

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[2] Regulations pertaining to income and franchise taxes; promulgated by the Commissioners of the District of Columbia on July 25, 1956, § 10.2-(c)(1)(a); set forth in full in the Appendix to Petitioner's Brief, p. 33a-34a.

> Code, and not shown on this record to be violative of the Constitution, we hold that the franchise tax levied against the General Motors Corporation for the years 1957 and 1958 was a valid one. * * *" (R. 527.)

This conclusion was based upon exhaustive consideration and discussion of the activities of General Motors Corporation within the District, the statute upon which the taxes were based, the regulation of the Commissioners which determined the amount of those taxes, and the relevant opinions and decisions of the appellate court and of this Court. Arguments that General Motors here advances are substantially identical with those it presented to the Court of Appeals. Because it cannot demonstrate that it was, in fact, taxed too much, and because it cannot demonstrate that the income subjected by the District to tax was, in any degree, greater than that which was "fairly attributable" to its District activities, General Motors necessarily argues the invalidity of the District's regulation on the basis of conclusionary remarks of the District of Columbia Tax Court and hypothetical extremes which even General Motors does not suggest are, in any way, applicable to it.

For many years the District of Columbia has employed for the apportionment of income, both under the District of Columbia Income Tax Act of 1939, 53 Stat. 1087, §§ 47-1501 to -1547, D.C. Code, 1961, and the District of Columbia Income and Franchise Tax Act of 1947, an apportionment formula utilizing sales where the taxpayer's business consists of manufacturing or purchasing personal property to be sold or resold. In this period of time, approximately 27 years, the District's formula has received repeated consideration by the highest court of the District. These cases have held the District's method of apportioning income for franchise tax purposes to be valid, and not to attribute to the District for tax purposes an unreasonable or improper

amount of income. *Smoot Sand and Gravel Corp.* v. *District of Columbia*, 104 U.S. App. D.C. 292, 261 F.2d 758 (1958), *cert. denied*, 359 U.S. 968 (1959); *Eastman Kodak Co.* v. *District of Columbia*, 76 U.S. App. D.C. 339, 131 F. 2d 347 (1942); *Panitz* v. *District of Columbia*, 74 U.S. App. D.C. 284, 122 F. 2d 61 (1941). In all of the foregoing cases the taxpayers raised contentions comparable to those made by General Motors that the District's formula for the apportionment of income is invalid for the reason that the products sold were produced outside the District and that the District's method of apportionment failed to take into account the taxpayer's production facilities. In *Smoot*, it was argued that decisions of this Court and the provisions of the Income and Franchise Tax Act of 1947 required the District to employ a three-factor apportionment formula based on sales, manufacturing costs and property values, a major proposition advanced by General Motors in this case. Thus, the District's formula has received detailed attention and consideration in all of its aspects; and reasons advanced by its opponents for its modification or invalidation have consistently been rejected.

General Motors says in its brief [3] that it can find no legislative history which would indicate Congressional intent supporting the theory of the statute adopted in the Commissioner's regulations. This assertion lacks foundation. The statute itself contains more than adequate authority for the use by the District of an apportionment formula based on sales.

The District of Columbia Income and Franchise Tax Act of 1947 was enacted as article I of the District of Columbia Revenue Act of 1947, 61 Stat. 331. Title VII, section 2 of that act (§ 47-1571a, D.C. Code, 1961) imposes a tax at the rate of five per centum upon the taxable income of every

[3] P. 27.

corporation whether domestic or foreign, except those exempt under the Act. The tax is expressly imposed "For the privilege of carrying on or engaging in any trade or business within the District and of receiving income from sources within the District * * *."

Title I, section 4(h) of this act (§ 47-1551c(h), D.C. Code, 1961) defines the words "trade or business" to include "engaging in or carrying on of any trade, business, profession, vocation or calling or commercial activity in the District of Columbia * * *"

Net income is defined by title III, section 1 of the act (§ 47-1557, D.C. Code, 1961) to mean the gross income of a taxpayer less certain deductions permitted under the Act. Gross income is stated in title III, section 2(a) (§ 47-1557a, D.C. Code, 1961) of the act, to include:

> "* * * income derived from any trade or business or sales or dealings in property, whether real or personal, other than capital assets as defined in this article, growing out of the ownership, or sale of, or interest in, such property; also from rent, royalties, interest, dividends, securities, or transactions of any trade or business carried on for gain or profit, or gains or profits, and income derived from any source whatever."

Title X, section 1, of the act (§ 47-1580, D.C. Code 1961) states that it is the purpose of the act to impose "(2) a franchise tax upon every corporation and unincorporated business for the privilege of carrying on or engaging in any trade or business within the District and of receiving such other income as is derived from sources within the District * * *." That section further provides that:

> "The measure of the franchise tax shall be that portion of the net income of the corporation and unin-

corporated business as is fairly attributable to any trade or business carried on or engaged in within the District and such other net income as is derived from sources within the District * * *."

Title X, section 2 of the Franchise Tax Act (§ 47-1580a, D.C. Code, 1961) provides, for District tax purposes, for apportionment of income derived by a corporation engaged in business both within and without the District of Columbia. In such cases, this section states that:

"* * * Where the net income of a corporation or unincorporated business is derived from sources both within and without the District, the portion thereof subject to tax under this article shall be determined under regulation or regulations prescribed by the Commissioners. The Assessor is authorized to employ any formula or formulas provided in any regulation or regulations prescribed by the Commissioners under this article which, in his opinion, should be applied in order to properly determine the net income of any corporation or unincorporated business subject to tax under this artiele."

By the Act of May 3, 1948, 62 Stat. 206, ch. 246, Congress amended the Income and Franchise Tax Act of 1947, to the extent that it involved the imposition of a franchise tax on corporations engaged in business within the District of Columbia. However, the amendments were restricted only to exempting or excluding from tax under the Act income derived under specific conditions from the sale of tangible personal property. Thus, by these amendments the Congress excluded from the definition of the words "trade or business" as used in title I, section 4(h) of the act:

"(1) Sales of tangible personal property whereby title to such property passes within or without the Dis-

trict, by a corporation or unincorporated business which does not physically have or maintain an office, warehouse, or other place of business in the District, and which has no officer, agent, or representative having an office or other place of business in the District, during the taxable year; or

"(2) Sales of tangible personal property by a corporation or unincorporated business which does not maintain an office or other place of business in the District and which has no office, agent, or representative in the District except for the sole purpose of doing business with the United States, but such corporations and unincorporated businesses shall be subject to the licensing provisions in title XIV of this article.

"For purposes of this proviso, the words 'agent' or 'representative' shall not include any independent broker engaged independently in regularly soliciting orders in the District for sellers and who holds himself out as such." § 47-1551c(h), D.C. Code, 1961.

In addition, the Act of May 3, 1948, added to the *exclusions* from gross income, as set forth in title III, section 2(b) of the Franchise Tax Act:

"(13) Income derived from the sale of tangible personal property to the United States by corporations and unincorporated businesses having their principal places of business located outside the District, which property is delivered from places outside the District for use outside the District: *Provided, however,* That the taxpayer shall furnish to the Assessor a statement in writing of the amount of gross sales so made and, if required by the Assessor, a list of the names of the agencies of the United States through which such property was sold." § 47-1557a(b)(13), D.C. Code, 1961.

Finally, the Act of May 3, 1948, amended title X, section I of the Franchise Tax Act (which deals with the measure of the franchise tax and with the purpose of the act) by adding a proviso which reads:

> "* * * *Provided further*, That income derived from the sale of tangible personal property by a corporation or unincorporated business not carrying on or engaging in trade or business within the District as defined in title I of this article shall not be considered *as income from sources within the District for purposes of this article, with the exception of income from sales to the United States* not excluded from gross income as provided in title III, section 2(b) of this article." (§ 47-1580, D.C. Code, 1961, italics supplied).

It is important to note that the Act of May 3, 1948, amending the District of Columbia Income and Franchise Tax Act of 1947, was confined to exclusion from District of Columbia corporation franchise tax of *income derived from sales of personal property* by corporations which, under the terms of the original act, had been taxed. The intention of the Congress in amending the Franchise Tax Act is clearly expressed in reports of the Senate and House Committees on the District of Columbia.

Senate Report No. 1042, 80th Cong., 2d Sess. (1948), stated the purpose of the bill, S. 2409, which was enacted as the Act of May 3, 1948, as follows:

> "The purpose of the bill is to clarify and *limit the imposition of a tax upon the income of corporations or businesses which is 'derived from sources within the District of Columbia.'* Due to the language appearing in the existing District of Columbia income-tax law, the imposition or assessment of the income tax was heretofore made against concerns casually engaged in

> business within the borders of the District of Columbia by such means as telephone, mail orders, traveling salesmen, and other non-consistent means of solicitation. This bill will correct such situation, and limit the imposition of an income tax to those concerns factually engaged in business on their own account or through representatives or agents within the District of Columbia." (Italics supplied.)

The report of the House Committee on the District of Columbia accompanying S. 2409(H.R. Rep. No. 1792, 80th Cong., 2d sess. (1948)), stated in part, that:

> "The purpose of the bill, as amended, is to clarify the language and intent in the District of Columbia Income and Franchise Tax Act of 1947, in order that the tax so provided be not imposed on corporations and unincorporated businesses which do not maintain places of business or representatives in the District of Columbia, or on such concerns which maintain places of business or representatives in the District for the sole purpose of doing business with the United States, in respect to sales of tangible personal property delivered outside the District for use outside the District." *Id.* p. 2.

Consideration of the original provisions of the District of Columbia Income and Franchise Tax Act of 1947, the May 3, 1948 amendments of the act, and the comments of the Committees of the Congress which considered those amendments, results in the conclusion that any regulations promulgated by the Commissioners of the District of Columbia which would have the effect of exempting from District of Columbia corporation franchise tax income derived by a corporation through sales of personal property in the District of Columbia, which is not exempt from tax by the

amendments of May 3, 1948, would be at variance with the intent of the Congress. This conclusion is required for the reasons that:

(1) All corporations engaged in carrying on any trade, business, or commercial activity in the District of Columbia, with the exception of certain organizations specifically exempt, are subject to a franchise tax for the privilege of carrying on that trade, business or commercial activity.

(2) The measure of the franchise tax to be paid by a corporation subject to tax is that portion of its net income as is fairly attributable to any trade or business carried on or engaged in within the District *and* such other net income as is derived from sources within the District.

(3) Net income, under the act, is gross income, which includes all income derived from sales or dealings in property, whether real or personal, and income derived from any trade or business or transactions of any trade or business carried on for gain or profit, or gains or profits, and income derived from any source whatever, reduced by specific deductions authorized under the act.

(4) The only exclusions from tax liability (as provided by the 1948 amendments) are the following:

(a) sales of tangible personal property by a corporation which does not physically have or maintain an office, warehouse or other place of business in the District, and which has no officer, agent, or representative having an office or other place of business in the District during the taxable year;

(b) Sales of tangible personal property by a corporation not maintaining an office or other place of business in the District except for the sole purpose of doing business for the United States;

(c) income derived from the sale of tangible personal property to the United States by corporations

having their principal places of business located outside the District, which property is delivered from places outside the District for use outside the District.

The application of the exclusionary provisions of the Franchise Tax Act, as those provisions relate to sales of tangible personal property, requires the conclusion that income from all other sales of tangible personal property to customers in the District of Columbia by a corporation engaged in a trade or business in the District of Columbia is taxable in the manner provided by the act.

In addition to the 1948 amendments, changes were made by the Act of May 27, 1949, 63 Stat. 129, ch. 146; the Act of May 18, 1954, 68 Stat. 117, ch. 218; the Act of March 31, 1956, 70 Stat. 70, ch. 154; the Act of September 4, 1957, 71 Stat. 605, Pub. L. 85-281; the Act of June 27, 1960, 74 Stat. 219, Pub. L. 86-522; and the Act of March 2, 1962, 76 Stat. 10, Pub. L. 87-408. Some of these enactments made extensive amendments, as, for example, the Acts of March 31, 1956, and of September 4, 1957. None has been directed to the apportionment of income for franchise tax purposes, nor has the Congress suggested that the District's apportionment formula is contrary to the intent and requirements of the Income and Franchise Tax Act. If the contrary were true, it can be assumed that changes in the act would have been enacted by the Congress so as to provide a method of apportionment different from that employed by the District in its regulations. *Farmers Union* v. *WDAY*, 360 U.S. 525, 532-33 (1959); *Allen* v. *Grand Central Aircraft Co.*, 347 U.S. 535 (1954); *Murphy Oil Co.* v. *Burnet*, 287 U.S. 299, 307 (1932).

Contrary to General Motors' arguments, it is clearly indicated that the Commissioners' regulations are consistent with the Congressional intent, not only by an analysis of the taxing statute, but by the opinion of the United States Court

of Appeals for the District of Columbia Circuit in *Lever Bros. Co.* v. *District of Columbia*, 92 U.S. App. D.C. 147, 204 F. 2d 39 (1953), where that court, after referring to the 1948 amendments to the Income and Franchise Tax Act of 1947, said (in footnote 7):

> "* * * The second proviso quoted above ('*Provided further* * * *') is essential to the tax exemption intended to be provided for businesses selling tangible goods without use of any District office. But for it, the enterprise would be taxable on account of receiving income from District sources, even if, by virtue of the first proviso, it was not 'doing business' in the District." 92 U.S. App. D.C. at 148-49, 204 F. 2d at 40-41.

In the opinion of the Court of Appeals in the present case the validity of this proposition was recognized to the extent that it constitutes a complete answer to the argument of General Motors that the statute neither contemplates nor sanctions the use of a formula for the apportionment of its net income in the manner provided by the District's regulation. In footnote 16 the Court of Appeals said:

> "The District argues here that, regardless of whether General Motors' income from District sales is taxable under the provision applicable to corporations conducting a trade or business in the district, it is taxable as 'other income * * * derived from sources within the District.' Since the Tax Court held that the income from District sales was taxable under the 'trade or business' provision and General Motors did not appeal that finding, and since we find the income to be *fully taxable* under the 'trade or business' provision, we need not at this time pass on the scope of the 'other income' provision. However, it should be noted that this court has interpreted that provision to cover income arising

> from transactions outside the scope of a regular 'trade or business' carried on within the District, such as rents, royalties, and income from the sale of real property. *District of Columbia* v. *Evening Star Newspaper Co.*, 106 U.S. App. D. C. 360, 273 F. 2d 95 (1959); see *Lever Bros. Co.* v. *District of Columbia, supra.* The interpretation called for by the District would result in an overlap of the two provisions not called for by the taxing scheme." (R. 512; italics supplied.)

The comment of the court that, "The interpretation called for by the District would result in an overlap of the two provisions ['trade or business' and 'other income'] not called for by the taxing scheme," is not a rejection of the District's contention of the statutory concept of income to be taxed. The court merely held that the contention of the District that the taxable income of General Motors is income "fairly attributable" to its District activities which, in this case, is also taxable as "other income" derived from District sources, brings about an unnecessary overlap. The fact remains, however, that whether the income is considered "trade or business" income or "other income * * * derived from sources within the District," General Motors was subjected to tax in a manner entirely consistent with the intent of the Congress and the specific provisions of the District's statute. *Cf. Lever Bros. Co.* v. *District of Columbia, supra; Owens-Illinois Glass Co.* v. *District of Columbia,* 92 U.S. App. D. C. 15, 204F. 2d 29 (1953).

General Motors Says (Pet's Br. p. 17):

> "* * * [The District's apportionment formula] allocated to the District 100 percent of the net income derived from the segment of petitioner's business involved in the manufacture of products without the District and their sale and shipment to customers lo-

cated within the District. Clearly, a portion of such income is fairly attributable to petitioner's related out-District activities involved in the manufacture-distribution process [references omitted]."

The statute demands that the income fairly attributable to General Motors' "trade or business" in the District be subjected to a corporation franchise tax for the exercise of that privilege. The trade or business carried on or engaged in by General Motors in the District is the sale of its products to District customers, combined with numerous other activities directed to the production and sale of its products within and without the District. As was said by the Court of Appeals in *Lever Bros. Co.*, it was the intention of the Congress in the Income and Franchise Tax Act of 1947, and its 1948 amendments, to broaden the concept of source of income for District franchise tax purposes. To this end, the Commissioners' regulation recognizes the intent of Congress. Except insofar as any method of apportionment will, as this Court has recognized, produce such an incidental result, the District's formula does not, as General Motors contends, tax income which is attributable to activities of the Company outside the District.

General Motors conducts a unitary business; its activities within the District are essentially the same as those conducted by it throughout the United States. Even if the statement in its brief concerning the effect of the District's apportionment formula were correct, the District would not be taxing more of General Motors net income than the statute clearly requires. It is not the trade or business which General Motors conducts *outside* the District which the statute says is to be considered for tax purposes; it is its trade or business within the District which subjects the corporation to tax.

In *General Motors Corporation* v. *State of Washington*, 377 U.S. 436 (1964), the Court sustained a direct, unapportioned tax upon General Motors' gross receipts. General Motors' commercial activities in Washington, although in certain respects comparable with those it conducts in the District of Coulmbia, were, in the aggregate, substantially less extensive that those the Corporation conducts in the District of Columbia. Moreover, as was Washington's, the District's franchise tax is imposed for the privilege of engaging in trade or business in the District. If the State of Washington may apply against General Motors an unapportioned gross receipts' tax, irrespective of the location of General Motors' production facilities, expenditures for employees' salaries, or their relation to "economic" income, the District's tax, determined by apportionment of General Motors' net income, is no less valid. Unlike Washington's direct tax upon gross receipts, the District apportioned for application of its franchise tax only a small fraction of General Motors' total net income. Thus, out of General Motors' total net income of $1,312,092,839.15 for the year 1957, the District apportioned only $5,455,682.00 as income subject to franchise tax, and, out of a 1958 total income of $653,396,893.13, the District apportioned only $3,379,368.73 as taxable income.[4]

Under the District's formula, the apportionment was made on the basis of General Motors' *entire* net income (including all of its losses as well as its gains—both within and without the District). Neither the District nor General Motors made any attempt at any stage of the proceedings to ascertain the precise amount of net income which General Motors, in fact, derived from its District activities. In the absence of such precise determination it is clear that the

[4] R. 372-75. It was stipulated that certain errors in the information supplied by the Corporation to the District would, if the District prevailed, result in a reduction of the tax. (R. 373.)

District's apportionment could not (except by sheer coincidence) result in allocation to the District, as General Motors contends, of 100 per cent of the net income derived from the sale by the Company to District customers of products manufactured outside the District. It is clear also that the amount of income apportioned to the District in no way reflects an inclusion of income which was beyond the power of the Congress to tax, nor was it inconsistent with statutory requirements.

II

The District's formula for apportionment is consistent with principles stated by this Court governing taxation of businesses engaged in interstate commerce.

Whatever may be the limitations of the Commerce Clause of the Constitution upon the authority of a state to impose taxes upon businesses engaged in interstate commerce, the Congress, in legislating for the District of Columbia, is not bound thereby. As was said in *Neild* v. *District of Columbia*, 71 U.S. App. D.C. 306, 310, 110 F. 2d 246 (1940), involving an act of Congress imposing a gross receipts tax upon the privilege of engaging in business within the District:

> "Subject only to those prohibitions of the Constitution which act directly or by implication upon the federal government, Congress possesses full and unlimited jurisdiction to provide for the general welfare of citizens within the District of Columbia by any and every act of legislation which it may deem conducive to that end. In fact, when it legislates for the District, Congress acts as a legislature of national character, exercising complete legislative control as contrasted with the limited power of a state legislature, on the

one hand, and as contrasted with the limited sovereignty which Congress exercises within the boundaries of the states on the other. As the commerce clause operates as a limitation solely upon the states, it constitutes no bar to the action of Congress in any event. * * *

"* * * It may exercise, also, within the District, general legislative powers delegated to Congress by the Constitution; as for example the power granted by the commerce clause. When its acts by virtue of these general legislative powers it is free of the restraints which are imposed by the Constitution upon the states." (Extensive footnotes omitted.)

Neild was cited with approval by this Court in *National Mutual Insurance Co.* v. *Tidewater Transfer Co.*, 337 U.S. 582, 601-02 (1949). General Motors recognizes the absence of any limitation upon the Congress resulting from the Commerce Clause,[5] but contends that, although Congress is not subject to a Constitutional restraint, it may not delegate its authority to local officers. It relies for this proposition upon *Stoutenberg* v. *Henning*, 129 U.S. 141. Such reliance appears to be misplaced for *Stoutenberg* did not involve a formula devised under an act of Congress for the apportionment of income for District tax purposes; it was concerned with an act of the District's legislative assembly, a body comparable in all respects to a state legislature. The enactment by the Legislative Assembly can hardly be compared to an amplifying regulation promulgated by the Commissioners pursuant to a specific pro-

[5] Pet's Br. p. 49.

vision in the Income and Franchise Tax Act of 1947 reading:

> "Where the net income of a corporation or unincorporated business is derived from sources both within and without the District the portion thereof subject to tax under this Article *shall be determined under regulation or regulations prescribed by the Commissioners.*" § 47-1580a, D.C. Code, 1961 (italics supplied).

It is a well-established principle of law that a regulation promulgated by an administrative body to implement a statute should be held invalid only where it clearly appears it is beyond the authority of those who promulgated it, or that it is inconsistent with or contravenes the statute upon which it is based. *Mitchell* v. *Budd,* 350 U.S. 473, 480 (1956) "Experts might disagree over the desirability of one formula rather than another. It is enough for us that the expert stayed within allowable limits."; *Commissioner* v. *South Texas Co.,* 333 U. S. 496, 501 (1948); *Fawcus Machine Co.* v. *United States,* 282 U.S. 375, 378 (1931).

General Motors complains that the Commissioners' regulation (although not the statute) unduly burdens interstate commerce.[6] But, if the regulation comports with the requirements of the statute relating to the imposition of District taxes, the regulation is valid. As the Court of Appeals said:

> "* * * Read as we read it, the statute clearly permits, although it does not require, the single-factor sales formula adopted by the Commissioners.
>
> "The General Motors interpretation is obviously a

[6] Pet. Br. pp 49-50.

complex and sophisticated one. We believe it more probable that the District's approach reflects the intent of Congress. A court should not apply a taxing statute more narrowly than its clear language imports unless there is some showing of Congressional intent that it should do so. * * *'" (R. 515.)

The interpretation of a statute by the highest court of a state becomes a part of the statute for the purposes of determining its validity. *Allied Stores, Inc.* v. *Bowers,* 358 U.S. 522, 526 (1959); *Wheeling Steel Corp.* v. *Glander,* 337 U.S. 562, 566 (1949). When it construes an act of Congress of local application the United States Court of Appeals for the District of Columbia Circuit occupies a position identical with that of the highest court of a state. The Court of Appeals, after an exhaustive examination of the matter, has concluded that the District's regulation comports with the District's taxing statute and that General Motors has been properly taxed in accordance therewith.

On the subject of Constitutional issues in tax cases this Court has stated:

> "* * * [W]hile it is true that we are not bound by the construction of local statutes by the local courts in deciding the Constitutional question, 'yet when we are dealing with a matter of local policy, like a system of taxation, we should be slow to depart from their judgment, if there was no real oppression or manifest wrong in the result.' *Clyde* v. *Gilchrist,* 262 U.S. 94, 97." *Atlantic Coast Line* v. *Phillips,* 332 U.S. 168, 170 (1947).

Since the Commerce Clause of the Constitution is inapplicable to the Congress when it legislates for the District of Columbia, it would seem that further reference to cases

involving impositions on interstate commerce is unnecessary, and that the cases themselves are inapposite. Nevertheless, because, in reliance on such cases, the Court is asked to resolve this case in favor of General Motors, it becomes appropriate to demonstrate that the application to the District of this Court's decisions on multi-state taxation of businesses fails completely to sustain General Motors' arguments.

International Harvester Co. v. *Evatt*, 329 U.S. 416, 422 (1947), held that:

> "* * * this Court has long realized the practical impossibility of a state's achieving a perfect apportionment of expansive, complex business activities such as those of appellant, and has declared that 'rough approximation rather than precision' is sufficient * * *. Unless a palpably disproportionate result comes from an apportionment, a result which makes it patent that the tax is levied upon interstate commerce rather than upon an intrastate privilege, this Court has not been willing to nullify honest state efforts to make apportionments. * * * A state's tax law is not to be nullified merely because the result is achieved through a formula which includes consideration of interstate and out-of-state transactions in their relation to the intrastate privilege * * *."

As was said in *Hump Hairpin Mfg. Co.* v. *Emmerson*, 258 U.S. 290, 295 (1922):

> "No formula has yet been devised by which it can be determined in all cases whether or not such a tax [affecting interstate commerce] is valid, and, applying the repeated declaration of this Court, in the cases cited and in many others, that the question is inherently

a practical one, depending for its decision on the special facts of each case, we are clear that the tax here involved falls within the accepted class described, even though the business done with residents of states other than Illinois be regarded as interstate."

As this Court stated in *Salmon* v. *State Tax Comm'n*, 278 U.S. 484, 491 (1929), where the taxpayer raised Due Process and Equal Protection of the Laws questions, "The fact that a better taxing system might be conceived does not render the law invalid."

The standard of reasonableness, rather than preciseness, which this Court has recognized as the salient factor to be considered, has been applied consistently in attacks upon state tax enactments. In each of the following cases, contentions similar to those made by General Motors were rejected and the taxes and legislation involved upheld: *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920); *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U.S. 271 (1924); *International Shoe Co.* v. *Shartel*, 279 U.S. 429 (1929); *Ford Motor Co.* v. *Beauchamp*, 308 U.S. 331 (1939); *Wisconsin* v. *J. C. Penney Co.*, 311 U.S. 435 (1940); *Norton Co.* v. *Department of Revenue of Illinois*, 340 U.S. 534 (1951); *United States Glue Co.* v. *Oak Creek*, 247 U.S. 321 (1918); *Butler Bros.* v. *McColgan*, 315 U.S. 501 (1942); *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450 (1959); *Northwest Airlines, Inc.* v. *Minnesota*, 322 U.S. 292 (1944); *Railway Express Agency, Inc.* v. *Virginia*, 358 U.S. 434 (1959). Although there are many other decisions of the Court in this area the cases cited are representative of those which have sustained state taxing measures when attacked on Constitutional grounds.

In none of the cases considered by this Court has it been determined that a method for the apportionment of income for state taxing purposes was invalid per se. Neither has

it been decided that an apportionment formula such as that employed by the District of Columbia is invalid merely because other jurisdictions may employ other formulas. In fact, this Court has sustained the use of similar single-factor formulas inherently comparable to that adopted by the Commissioners of the District of Columbia. *Ford Motor Co.* v. *Beauchamp, supra, Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Comm'n, supra,* and *Underwood Typewriter Co.* v. *Chamberlain, supra.* See also *Kent-Coffey Mfg. Co.* v. *Maxwell,* 291 U.S. 642 (1934); *Norfolk & W. Ry.* v. *North Carolina,* 297 U.S. 682 (1936); *Nashville, C. & St. L. Ry.* v. *Browning,* 310 U.S. 362 (1940).

It is notable, as found by the Special Subcommittee on State Taxation of Interstate Commerce of the House Committee on the Judiciary, that consistency in state apportionment formulas, each presumably equally valid, does not exist and that the District is not alone in apportioning income on the basis of a sales factor formula.[7]

General Motors couples its contentions involving the Commerce Clause with references to the due process clause of the Fifth Amendment. Pet's Br. p. 28. It cites *Wallace* v. *Hines,* 253 U.S. 66 (1920); *Miller Brothers* v. *Maryland,* 347 U.S. 340 (1954); *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450 (1959); *New York, Lake Erie & Western R.R. Co.* v. *Pennsylvania,* 153 U.S. 628 (1894); *Fargo* v. *Hart,* 193 U.S. 490 (1904), and *Hans Rees' Sons, Inc.* v. *North Carolina,* 283 U.S. 123 (1931).

Wallace v. *Hines* involved taxation of an interstate railroad by North Dakota, using a formula based on trackage. The case turned on the facts rather than the formula. *Miller Brothers* concerned the authority of Maryland to assess and collect use taxes from a company which, although

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[7] See Report of the Special Subcommittee on State Taxation of Interstate Commerce, H.R. Rep. No. 1480, 88th Cong., 2d sess., vol. 1, p. 119 (1964).

products it sold were delivered from time to time to Maryland customers, had no business outlets in the state. *Northwestern States Portland Cement Company* sustained the state's tax even though it involved a portion of the income of the company related to interstate business. As this Court said:

> "We conclude that net income from interstate operations of a foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to local activities within the taxing State forming sufficient nexus to support the same." 358 U.S. at 452.

New York, Lake Erie, and Western R.R. Co. presented the question whether Pennsylvania could compel a New York Railroad company to deduct Pennsylvania's property tax from interest due Pennsylvania residents on bonds of the railroad held by such residents. The issue has no relevance to the issues here. *Fargo* v. *Hart* concerned a property tax imposed upon an express company determined on an apportionment formula based upon mileage. The vice of the formula stemmed from its application principally to real and personal property of the taxpayer permanently located outside the taxing state and not necessarily used in its actual business. The total effect of these cases is simply to prescribe a rule that a state taxing statute must not be so applied as to cause the payment of a tax unreasonable in amount and unrelated in fact to activities of the taxpayer within the taxing jurisdiction.

Under the heading "History Of Relevant Decisions" General Motors cites a number of cases which, with one exception, sustained state taxes. It refers to *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113, 120 (1920), where this Court stated:

> "[Connecticut's] tax is based upon the net profits earned within the State. That a tax measured by net profits is valid, although these profits may have been derived in part, or indeed mainly, from interstate commerce is settled."

General Motors states that the District argues, as did Underwood, that income was "attributable only to the process of sale," and that "it is of no consequence where the factory is located." (Pet's Br. p. 30.) The District makes no such assertion. Its contention is that it has fairly apportioned General Motors' net income for District franchise tax purposes consistent with the District's taxing statute and with the intent of Congress. General Motors is correct as to the District's position only to the extent that "it is of no consequence where the factory is located." The position is sound for the reason that the District is not imposing a tax based upon the location of a factory; it imposes a tax, as required by the Congress, because General Motors engages in "trade or business" within the District, derives a portion of its total net income from its operations within the District, and its net income from District sources is subject to tax. The following statement of the Court in *Underwood* appropriately describes the District's statute and the regulation of the Commissioners implementing it:

> "The legislature in attempting to put upon this business its fair share of the burden of taxation was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders. It, therefore, adopted a method of apportionment which, for all that appears in this record, reached, and was meant to reach, only the profits earned within the State. * * * " 254 U.S. at 120-21.

General Motors places considerable reliance upon the frequently cited *Hans Rees' Sons, Inc.* v. *North Carolina*, 283, U.S. 123 (1931). The Court invalidated the tax because Hans Rees' average income from its North Carolina activities was approximately 17 per cent of its total income, whereas the State allocated to itself for tax purposes approximately 80 per cent of the firm's income. In discussing the effect of the North Carolina statute, the Court said at p. 135:

> "It is sufficient to say that, in any aspect of the evidence, and upon the assumption made by the state court with respect to the facts shown, the statutory method, as applied to the appellant's business for the years in question operated unreasonably and arbitrarily, in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted by the appellant in that State. * * *"

The extreme situation admittedly present in *Hans Rees'* is completely absent here. General Motors made no attempt to show, nor did the Tax Court find, that the corporation's income from its District trade or business was less in any stated degree than that ascribed to it through use of the District's apportionment formula. There was in *Hans Rees'* direct evidence concerning the maximum income the corporation could have derived from its activities in North Carolina, a fact not present in this case. The statement by General Motors that the Court of Appeals was, under *Hans Rees'*, bound to accept the Tax Court's unfounded conclusion concerning the effect of the District's taxing formula, completely disregards the difference between the evidence in *Hans Rees'* and the evidence before the Tax Court.[8] There is certainly no comparison between

[8] See Pet.'s Br. pp. 37-38.

the apportionment for District tax purposes of approximately four-tenths of one per cent of General Motors total net income for each of the tax years, and the apportionment to North Carolina for state tax purposes of 80 percentum of Hans Rees' net income. The differences between the two cases is so complete in this regard as to make *Hans Rees'* entirely inapplicable. Aside from the percentage differences, the total absence of any proof by General Motors tending even remotely to show that it was overtaxed makes this case comparable to *Underwood Typewriter Co.* v. *Chamberlain,* 254 U.S. 113, rather than to *Hans Rees'*.

In *Underwood* the Court noted the failure to show that the Company's income subjected to tax was not reasonably attributable to its activities in Connecticut. As in *Underwood:*

> "[General Motors] has not even attempted to show this; and, for aught that appears the percentage of net profits earned in [the District] may have been much larger than [the amount attributed to the District]. There is, consequently, nothing in this record to show that the method of apportionment adopted by the [District] was inherently arbitrary, or that its application to this corporation produced an unreasonable result." 254 U.S. 121, with bracketed language added.

Underwood also furnishes an answer to the hypothetical examples used by General Motors to demonstrate invalidity of the District's apportionment formula based upon factual assumptions completely irrelevant to General Motors. (See Pet.'s Br. pp. 19-20.) Continuing in *Underwood,* the Court said:

> "We have no occasion to consider whether the rule prescribed if applied under different conditions might be obnoxious to the Constitution." 254 U.S. at 121.

If General Motors is entitled to relief, it can be only because of facts applicable to it, not because under some other circumstances the District, in order to achieve a proper apportionment of income for franchise taxes, might find it necessary to devise a different apportionment formula.

III

There is no substantial evidence that General Motors was subjected to "double taxation," and even if this were so, the District's tax is not invalidated by actions of other taxing jurisdictions.

General Motors claims that it proved that it had been subjected to "double taxation" and that the Tax Court so found. (Pet's Br. pp. 51-52.) In its original findings of fact no reference whatsoever was made by the Tax Court to the alleged "double taxation". The only statement concerning taxes is found in paragraph 3 of the findings of the Court (R. 437-38) where it was stated:

> "3. The petitioner in accordance with the statutes of the respective states filed income tax returns and paid income taxes for the taxable years involved as follows:

Year	*State*	*Amount*
1958	Delaware	$ 127,844.95
1957	Maryland	510,792.31
1958	Maryland	271,425.75
1957	Michigan	8,955,799.55
1958	Michigan	18,130,000.00"

Indeed, the Tax Court apparently considered so insubstantial or lacking in relevancy the fact of the payment by General Motors of taxes to other jurisdictions that it did not in its opinion even refer to such tax payments. (R.

438-63.) The findings relied on by General Motors were added as a consequence of a motion filed by it to amend the findings of fact and opinion. The motion (R. 474) requested that finding of fact No. 3 be amended by adding a sentence to read:

> "A portion of the income of petitioner derived from sales within the District of Columbia of goods manufactured in those states [the states listed in the original finding] was taxed by the states, pursuant to the apportionment formulas provided by their laws."

General Motors explained its desire for this additional sentence by stating in its motion:

> "With respect to the requested additional sentence, the grounds of this motion are that a finding that taxes were paid to other states becomes meaningful *only* if such taxes were based *in part* on the same income taxed in the District." (Italics supplied; R. 474.)

Although objected to on the ground that the requested sentence was unsuported by the record, and in any event that there was "no proof that the taxes were properly computed, were required to be paid, or were based in part on the same income as was taxed by the District" (R. 480) the Tax Court, with minor modifications, agreed to its inclusion. (R. 495.) The reason for its action, said the court, was that "the statement that a portion of the income from the sales here involved was taxed by other states under formulas provided by their laws is supported by documentary evidence herein." Although not identified by the Court, General Motors, in its motion, relied upon the following:

"The requested finding is supported by Exhibits 9, 12, 15, 18, and 19 (tax returns) and by the statutes of which the court took judicial notice (R. 88-89, 93, 98, Ex. 8)." (R. 474.)

There is ample reference in the record to the tax returns and to the basis upon which they were received in evidence. General Motors introduced in evidence copies of the corporation's income tax returns filed by it with the States of Maryland and Michigan for the year 1957 and with the States of Delaware, Maryland, and Michigan for the year 1958, together with canceled checks representing payment of taxes to Maryland and Michigan for the years 1957 and 1958 and to Delaware for the year 1958. (R. 14-19). In connection with the introduction of the tax returns and the payment of the taxes the Tax Court stated that the accuracy of the material contained in the returns was not assumed, that they were accepted merely for the purpose of showing that taxes based on income were paid to several taxing jurisdictions, but that they were not to be taken as proof of the facts alleged therein.[9]

No attempt was made by General Motors to establish through cogent evidence the fact of "double taxation" for which it contends here, and it introduced no facts concerning the nature or correctness of the items reflected on its returns, or the connection of those amounts to amounts involved in the computation of the District's tax. (R. 20-23.)

Despite the failure of General Motors to do anything more than to produce the tax returns filed by it with three states out of a total of 29 in which it said it was engaged in business and subject to state income taxes (R. 258), it

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[9] See discussion between court and counsel. (R. 14, 23-24.)

deduces that the District of Columbia, but not any other taxing jurisdiction, over-taxed it. Reduced to its simplest terms, General Motors says that the formulas for income apportionment used by Maryland, Michigan, and Delaware are legally permissible formulas; that they were applied to it, and that, having paid taxes thereunder based on items in a formula which, it says, but did not prove, were properly reported by it on its tax returns, the District was prohibited from proceeding under its laws to apportion General Motors' income in a manner which, in the abstract, might overlap the taxation of its income by other jurisdictions.

Although General Motors attacks the statement of the Court of Appeals that the Company failed to prove "double taxation," the fact is that the Court of Appeals was correct. The Tax Court's findings, upon which General Motors almost completely relies, made no attempt to state any specific amount of the net income claimed to be doubly taxed. That court said only that some unidentified portion of General Motors' net income was taxed by Maryland, Michigan, and Delaware. Even if the Tax Court was correct, the amount of "double taxation" was not ascertained.[10]

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[10] It was stated by a witness for General Motors that the Company has business establishments in 38 states and the District of Columbia. (R. 2.) Reference to 29 of those states imposing income taxes was submitted by General Motors. (Pet's. Ex. 22; R. 258-60, 398). The remaining 9 states are not identified, although undoubtedly taxes of some kind were paid by General Motors to those jurisdictions. It is inconceivable that all of these taxing jurisdictions, with the exception of the District of Columbia, so applied their tax laws as to avoid the abstraction of "double taxation," leaving the District as the sole jurisdiction which, to some unstated amount, has subjected the Corporation to double taxation. This Court has never held that a state may not take into account for tax purposes activities or items which legitimately may also be considered by another state in the application of its taxing measures. This is precisely what General Motors requests the Court to do.

General Motors necessarily errs in relying (Pet's Br. p. 53) upon the statement of the Tax Court that the District's apportionment formula attributed to the District 100 per centum of the net income derived by petitioner from that segment of its business consisting of the manufacture without, and the sale of products within, the District.

There is no evidence whatsoever concerning the actual amount of net income obtained by General Motors from its District activities. Since the Tax Court found that the District taxed 100 per centum of the Corporation's net income from the manufacture of products without and their sale within the District, it follows that the Tax Court premised its conclusion upon the hypothesis that General Motors' operations in the District were profitable. There is no evidence, however, that General Motors had equally profitable activities in each of the other jurisdictions in which it operates. Since the District apportioned General Motors' total net income, which necessarily had been computed by including all transactions whether profitable or not, or resulting in a loss, the amount of the net income apportioned to the District could well be below the actual net income General Motors obtained from District operations. The entire matter is thus based upon speculative reasoning for, without definitive facts, the reasoning cannot be objective.

In progression, by the method espoused by General Motors, it could be argued that every taxing jurisdiction has in some degree taxed income which was not the result of the activities of General Motors in the taxing jurisdiction, and particularly would this be true in the case of a state which imposed a tax against General Motors even though General Motors had sustained in that state a loss. *Cf. Butler Bros* v. *McColgan*, 315 U.S. 501 (1942).

IV

General Motors has not demonstrated, nor can it, that the franchise taxes imposed by the District of Columbia were excessive.

Relying on statements of the Tax Court which can be best described as pronouncements, rather than findings, and which are unsupported by the evidence presented, General Motors argues that the District's regulatory apportionment formula produced as to it an unreasonable result.[11] In *Boske* v. *Comingore*, 177 U.S. 459, 470 (1900), this Court stated the rule to be applied in the case of regulations promulgated pursuant to statutory authority:

> "* * * In determining whether the regulations promulgated by [the Secretary of the Treasury] are consistent with law, we must apply the rule of decision which controls when an act of Congress is assailed as not being within the powers conferred upon it by the Constitution; that is to say, a regulation adopted under section 161 of the Revised Statutes should not be disregarded or annulled unless, in the judgment of the court, it is plainly and palpably inconsistent with law. Those who insist that such a regulation is invalid must make its invalidity so manifest that the court has no choice except to hold that the Secretary has exceeded his authority and employed means that are not at all appropriate to the end specified in the act of Congress."

The Tax Court, in making its initial findings of fact, adopted in their entirety the facts stipulated by the parties. (R. 437.) It added minor references to the locations of General Motors' business establishments and man-

[11] Pet.'s Br. pp. 35-45.

ufacturing activities, and a reference to the filing by General Motors of income tax returns and payment of income taxes to the states of Delaware, Maryland, and Michigan. (R. 437-38.) It is significant that no characterization of the District's formula appeared in the findings of fact until *after* the court had concluded that it would not apply the District's apportionment formula, but would resolve the case upon a formula it created consisting of the factors of property, payroll, and sales, equally weighted. (R. 456, 459.) The reason which the Court used for its rejection of the District's formula and the creation for purposes of this case of a multi-factor formula was that "* * * the Court does not believe that a one factor formula of sales can, consistent with the Act, be used where, as here, the trade or business involved is the manufacture of tangible personal property without, and the sale thereof within the District." (R. 447.)

As a review of the statute and of the cases considered by the United States Court of Appeals shows, the action of the Tax Court was novel and at variance with prior decisions of the Court of Appeals.

Following the Tax Court's initial findings of fact, General Motors, presumably for the purpose of strengthening the findings, as well as the Tax Court's opinion, moved the Court to make certain amendments to the findings and opinion. (R. 474-79.) Among the findings requested by General Motors were the following:

> "5. The segment of petitioner's business that is conducted both within and without the District of Columbia involves the manufacture of a certain number of automobiles and kindred products wholly without the District and the sale thereof to customers within the District. The net income from this segment of petitioner's business is earned by and is fairly attributable

to both its manufacturing and selling activities, and such net income is earned in part by the manufacture outside the District of the articles sold to customers within the District. While such net income is not *realized* until sale, it is *earned* in part by the manufacture of the article sold.

"6. The method used by respondent attributed to the District 100% of the net income derived by petitioner from that segment of its business which consisted of the manufacture and sale of the products which were sold to customers in the District, which percentage is out of all appropriate proportion to the business carried on or engaged in by petitioner within the District." (R. 474-75).

Despite strong objection (R. 479) in which it was pointed out that, with the exception of the first sentence of proposed paragraph 5, "the remainder of the proposed findings is directed not to facts, but to conclusions of law", the Tax Court adopted almost without change General Motors' requested findings. (R. 480, 495-96.)

Primarily, therefore, the contentions of General Motors in this case are based upon its *own* statements concerning the District's apportionment formula. Despite the acceptance of these statements by the Tax Court, they represent conclusions, unsupported in the record, and unsupported in the findings of fact. As General Motors recognizes in its brief[12] the statements of the Tax Court which General Motors prompted, and upon which it so heavily relies, were rejected by the Court of Appeals. That court described finding No. 6 of the Tax Court to be based, not upon fact, but solely upon a conclusion of the Tax Court concerning the nature of the District's taxing statute. (R. 517.)

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[12] Pet's Br. p. 37.

Support for General Motors' contention, as set forth in its brief,[18] that it has unreasonably been taxed consists of a quotation of the Tax Court "findings", references to the nature of General Motors' business and to the amounts of its property and payroll, and mention of the testimony of economists who testified on its behalf.

Of course, the burden of showing that the District's determination of General Motors' liability was improper was upon petitioner. It did not carry this burden simply by showing that it manufactured outside the District, products sold within and without the District, nor by establishing its payroll costs and book values of its real and personal property. With the exception of the admitted fact that General Motors conducts manufacturing activities outside the District, the description of General Motors' activities within the District, including organizational control principally in Michigan, was stated in the stipulation between the parties to be as follows:

> "Petitioner's methods of doing business and selling and distributing it products as described [in the stipulation] are the same throughout the country." (R. 261.)

Unless the fact of manufacturing is of such importance as to require that any formula for the apportionment of General Motors' income must include factors which will, in some manner, weigh manufacturing, the District's formula for apportionment of income, based as it is upon General Motors' "trade or business" in the District, is not subject to rejection simply because another formula, permissive in nature, would produce for General Motors a different tax result.

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[18] Pet's Br. pp. 35-45.

General Motors says that expert testimony presented by it before the Tax Court showed the unreasonable and arbitrary character of the District's formula. (Pet's Br. p. 58) The Tax Court made no finding concerning the testimony of the experts who appeared either on behalf of General Motors Corporation or on behalf of the District of Columbia. In fact, noting that these witnesses were diametrically opposed, the Tax Court said: "Both sets of witnesses were in error." (R. 453.) Interestingly enough, the Tax Court commented that the statements of expert witnesses for General Motors who, in the Court's words, said "that the assessment in this case resulted in attributing to the District a percentage of income out of all proportion to business transacted by them there," (R. 453-454) were immaterial in view of *Smoot Sand & Gravel Co., supra,* a case which the Tax Court had decided in favor of the District and which was affirmed by the Court of Appeals.[14]

The witnesses for General Motors were not themselves in agreement concerning the proper method of apportioning General Motors' income for District tax purposes. Professor Studenski said unequivocally that sales should not be included in an apportionment formula which, he stated, should consist only of property and payrolls. The remaining three economists believed that the formula should consist of payrolls and property, but that the inclusion of sales as a factor would not be objectionable because, they said, sales might, in some manner, reflect costs not represented in property and payrolls. (R. 30, 40, 42-44, 47, 66-67, 76-77, 83-85, 92, 95, 99, 102, 104, 212, 226,

[14] In view of this statement by the Tax Court it is not entirely clear why the Tax Court later amended its findings to include language which it had said was immaterial, particularly in view of the fact that it had rejected the testimony of all the witnesses as being incorrect and had noted that the expert witnesses for the District of Columbia were opposed to the expert witnesses for General Motors.

227, 229-31.) Professor Paton contended that income is represented entirely by costs and that there is no other available process for determining income. But, he said, a formula consisting of payrolls and property "would make a pretty good rule of thumb. It is not ideal but payroll does describe the personal situation, personal service." (R. 26-29, 39.)

Professor Morton admitted that sales were as necessary as land, labor, capital, and enterprise, and that neither expenses nor property creates income. He also denied that sales would create income. (R. 212, 223, 237.) Testifying as to the manner in which he would determine "income" based upon the application of labor, capital, and enterprise, Professor Morton stated that the sale of the item produced is probably the best way to measure the total value of the output and that this measure is the one most commonly used. As he said, inherent in the price of the product sold, when considered in respect of realistic income, are all the items of land, labor, capital, and enterprise to which he referred as "costs". He doubted whether any practical formula could be devised which would take into account all of the variations and contributions inherent in the production of income. (R. 239, 253.)

Expert economists testifying for the District disagreed completely with the witnesses for General Motors. Dean Bailey, Professor Watson, and Mr. Robert Nathan each denied that the District's formula was unreasonable and unfair. (R. 127-30, 163-65, 189-92.) None of these witnesses was of the opinion that a formula consisting of property and payroll, or property, payroll, and sales would produce a better apportionment of General Motors' net income fairly attributable to its business activities in the District than the District's formula (R. 130-31, 168, 192-99.) Professor Watson stated that the District formula achieves the best apportionment available. (R. 163-67.) Dean Bailey testi-

fied that income did not arise from capital. As he said, it arose in the case of General Motors from sales, even though manufacturing activities made possible the products sold. (R. 139-43, 147-49, 155.) Mr. Nathan gave as his opinion, from a practical standpoint, that it was impossible to arrive at a "conglomerate aggregate" formula which would take into consideration all of the elements which influence and determine the level of profits or profitability. (R. 189, 192.) On the matter of uniformity, he commented that the District's formula, uniformly applied throughout all taxing jurisdictions, would produce uniform results. (R. 193.) It was his opinion that although any formula has elements of arbitrariness, a tripartite formula could contain elements of arbitrariness, in many ways just as arbitrary, if not more so, than the District's formula. (R. 192.) As he said, a formula consisting of labor, capital, and sales is merely a summation of the deficiencies of each of the factors. (R. 195, 197.) Queried on the matter of arbitrariness in the District's formula, Mr. Nathan said:

> "* * * I think I could develop illustrations frankly which would appear to be just as arbitrary in their application from many other formulas from this one, and in view thereof and the simplicity of it I think that even though there may be extremes where it would not appear to be applicable I still think it is the best." (R. 202.)

Summarized, the testimony of the District's economists was that the District's apportionment formula is fair and reasonable and consistent with sound economic theory; that it achieved a proper apportionment of General Motors' net income; and that a multi-factor formula would not produce a more reasonable result.

The selection by General Motors of the testimony of its

economists, which was contradicted by the District's economist, and which was not accepted by the Tax Court, demonstrates only the arguments which may arise in connection with the use of any formula and the arguments which may be presented concerning the elements such a formula should contain.

The Tax Court itself recognized the limitations inherent in the formula it devised and the formula for which General Motors contends. As it said in its memorandum of February 27, 1962, which followed its original findings of fact and opinion:

> "No formula can accurately apportion net income in circumstances present in this case. At best it can only be an approximation. Taxation, as has often been said, is not an exact science. While the three factor formula is generally recognized as appropriate under the circumstances like those herein, there are several schools of thought in relation to the content and delineation of the factors. For instance, some administrators and experts contend that the factor of property should represent the present actual value. Some believe rented property should be included, while others it should be excluded. As to payroll, there is one school which holds that the place wherein the compensation is paid, while others claim that the place where the services are performed is the locale. There is even more disagreement on sales. Among others, is whether the situs should be determined by 'origin' or by 'destination.' * * *." (R. 493.)

Recognition of this problem appears in the Opinion of the Court of Appeals where it was said in footnote 20 (R. 514):

"* * * It is not at all clear that the three factor formula is even a close approximation of the kind of economic breakdown called for. While there is some relationship between the cost of payroll and property attributable to a certain stage and the income arising from that stage, it is not at all certain what that relationship is. Moreover, the sales process, being the end product of all the other stages and responsible for the actual receipt of the *money* income, could be said to be the most important stage, thus permitting a greater proportionate share of the income to be assigned to it vis-a-vis the other steps in the process."

The total amounts of General Motors payrolls and properties, both within the District and everywhere, were stipulated by the parties. (R. 385-88.) The stipulation was, however, subject to the following stated conditions:

"11. It is further understood and agreed that the dollar amounts set forth in Paragraphs 9 and 10 of this Supplemental Stipulation are included herein at Petitioner's request in order that strict and formal proof of said dollar amounts shall not be required, and Respondent has agreed to their inclusion solely for the purpose of reducing the time required for the trial of these cases. Respondent, by so agreeing, does not, however, stipulate or concede that these amounts or the basis upon which they are predicated are pertinent, material, relevant, or that they may be admitted into evidence, and Respondent specifically reserves the right to object to the admission of said Paragraphs 9 and 10." (R. 388.)

Although the manner in which payroll and property amounts were determined was stated in the stipulation,

without, however, the acceptance by the District of their validity for this case, no attempt was made by General Motors to show the relative contribution of any of its properties to its net income, nor the relative contributions which the payment of salaries and wages to employees made to the production of income. Admittedly, the accomplishment of such a matter would probably have been impossible, but the fact remains that the items of property and payroll have no specific signficance unless it is assumed, as General Motors argues it should be assumed, that the failure to include these items, equally weighted, in a formula causes an invalid apportionment of the corporation's net income for tax purposes. Even if a formula consisting of the factors of property, payrolls, and sales were used for the apportionment of General Motors' income, it does not follow that such an apportionment would achieve a better determination of its income from District sources than was obtained by use of the District's formula.

General Motors, again finding support in the views of its economists, which the Tax Court declined to accept, presents in its brief computations it made concerning the percentages which its payrolls and property bore to General Motors' total net income. But the percentages demonstrate only what any such mathematical computation could achieve, a product. (See Pet's Br. p. 43.) The comparative computations used by General Motors do not establish its income from its trade or business in the District, any more than would a percentage based upon the total number of General Motors' employees in the District to its total net income.

Conclusion

The Court of Appeals, in its opinion sustaining the assessment by the District against General Motors of corporation franchise taxes, fully considered and properly rejected contentions of General Motors substantially identical with those it now presents. The judgment of the Court of Appeals should, in all respects, be affirmed, with costs assessed against General Motors.

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IN THE

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DISTRICT OF COLUMBIA, *Respondent.*

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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REPLY BRIEF FOR THE PETITIONER

REPLY TO COUNTER-STATEMENT OF THE CASE

Respondent devotes 17 pages (Br. pp. 2-19) to a paraphrase of the lengthy stipulation of facts and exhibits thereto (R. 260-371), apparently hoping by mere volume of words to impress the Court with the extent of the petitioner's District activities.[1] The verbiage

[1] The paraphrasing has produced some inaccuracies. If the details are considered material, the stipulation itself should be consulted.

adds nothing of substance to the facts as summarized in our brief, pp. 4-6, 7-8, and tends to obscure the fact that, with very minor exceptions (see Pet. Br. p. 5, note 2), the zone offices concerned with car, truck and coach sales (accounting for approximately 95% of the net income sought to be taxed (R. 377-380)) were located outside the District. The zone office activities described at length by respondent were performed outside the District by personnel based outside and residing outside, except for the regular visits to dealers by the "district managers" and the less frequent and irregular visits by higher level personnel, as will appear from the record references to which respondent refers. It is wholly irrelevant that the zone offices "were located within the Washington Metropolitan Area" (Resp. Br. 5-6), the only facts of legal significance being that they were not located in the District and their personnel did not reside here. The zones covered large territories (Maryland, Virginia, and variously parts of other states) of which the District was only a small part, and many dealers of whom only a few were in the District (e.g., the Pontiac zone had 120 dealers of whom only four were in the District (R. 262)).

The several small offices in the District (R. 285-306) either had no selling function at all or were involved with only an insignificant fraction of the District sales here taxed (R. 377-380). Those offices undoubtedly contributed generally to the production of petitioner's income, but their contribution is not measured by the amount of District sales. Their presence had no bearing on the assessments and their activities were not taxed. The lengthy description of these offices serves merely to emphasize the illogic of respondent's regula-

tion and its application. By including their property and payroll in the fraction numerators, the Tax Court taxed all those activities in direct proportion, a result which is not only eminently just but expressly required by the statute.

The lengthy description (Resp. Br. 3-5) of the Dealer Selling Agreement adds nothing to the controlling facts. What the dealers are required to do does not explain what petitioner does, nor, more importantly, where it does it.

We do not agree with respondent's analysis of the expert testimony and we sharply dissent from its statement that the Tax Court made no findings based on that evidence (Resp. Br. 19-21, 55-64), a matter fully treated *infra*, pp. 21-27.

Respondent suggests that because the District's formula assessed only about four-tenths of one percent of petitioner's total net income, the assessments are reasonable. That is obviously the wrong comparison and a complete *non sequitur*. The amount of income which petitioner earned outside the District has no bearing whatever on the amount of tax due the District (except that such income must be excluded from the District tax base). As clearly established by the stipulated facts and the expert testimony, respondent assessed 100% of the income derived from the entire process of manufacture and sale, almost entirely outside the District, to customers within the District, and *eleven times* the income attributable to activities within the District (Pet. Br. 43). These two figures —100% and eleven times—are the relevant ones; the four-tenths of one percent has no relevancy.

The statement on page 21 of respondent's brief that the Tax Court refused to follow petitioner's experts'

recommendation of a two-factor formula (property and payroll, measuring capital and labor) is misleading. Petitioner did not request a two-factor formula. Although it is clear that only a two-factor formula makes any economic sense, which is what the experts testified, petitioner raised no objection to the use of three factors because the states (Michigan, Delaware and Maryland) in which petitioner manufactures most of its products sold to District customers include a sales factor, and hence omitting it from the District formula would permit roughly a third of petitioner's income from that business to escape tax. Petitioner has no such ambition, and requested a three-factor formula, as applied by the Tax Court, to assure that 100% of its income, no more and no less, would be taxed.

It is petitioner's position that the contribution of its business activities in the District to its total net income cannot be gauged by mere verbal description of the activities, but only by a quantitative measure which takes into account the relative value of the activities elsewhere which likewise contributed to such income; and that this is best achieved by applying ratios reflecting the costs of the services applied in the different jurisdictions and the relative capital investments (Pet. Br. p. 42).

ARGUMENT

1. THE ASSESSMENTS ARE CONTRARY TO THE STATUTE

The Force of the Decision Below

Respondent devotes little argument (Resp. Br. pp. 25-26, 41-42) to supporting the determination of the court below that "the statute clearly permits, although it does not require, the single factor sales formula adopted by the Commissioners" (R. 515). Since peti-

tioner has dealt fully with that question in its opening brief (pp. 12-27), little need now be added to that discussion.

Respondent attempts to preclude this Court from deciding the statutory question by the assertion (Resp. Br. p. 42) that "When it construes an act of Congress of local application the United States Court of Appeals for the District of Columbia Circuit occupies a position identical with that of the highest court of a state", and hence that "the interpretation of a statute by [that court] becomes a part of the statute for purposes of determining its validity." Respondent overlooks a very important distinction. Whereas this Court is bound in most circumstances to accept a state court's construction of its own statutes (*Guaranty Trust Co.* v. *Blodgett*, 287 U.S. 509, 513; *cf. Atlantic Coast Line* v. *Phillips*, 332 U.S. 168, 170), this Court's reluctance "ordinarily" to review decisions of the Court of Appeals based upon statutes confined in their operation to the District of Columbia is a matter of certiorari policy (*Del Vecchio* v. *Bowers*, 296 U.S. 280, 285) and deference to the local court (*Griffin* v. *United States*, 336 U.S. 704, 718). It is not a question of power, as this Court has frequently demonstrated by reversing determinations of District law by the Court of Appeals.[2] Particularly where the statutory ques-

[2] *District of Columbia* v. *Murphy*, 314 U.S. 441, 449-458, *reversing* 73 U.S. App. D.C. 345, 119 F. 2d 449; *Lynch* v. *Overholser*, 369 U.S. 705, 710-720, *reversing* 109 U.S. App. D.C. 404, 288 F. 2d 388; *Carroll* v. *United States*, 354 U.S. 394, 408-415, *reversing* 98 U.S. App. D.C. 244, 234 F. 2d 679; *District of Columbia* v. *John R. Thompson Co.*, 346 U.S. 100, 112-113, *reversing* 92 U.S. App. D.C. 34, 203 F. 2d 579; *Loughran* v. *Loughran*, 292 U.S. 216, *reversing* 62 U.S. App. D.C. 292, 66 F. 2d 567; *Washington Fidelity Nat. Ins. Co.* v. *Burton*, 287 U.S. 97, *reversing* 61 U.S. App. D.C. 3, 56 F. 2d 300.

tion is "enmeshed with constitutional issues", this Court has not hesitated to make its own determination of District law. *District of Columbia* v. *Little,* 339 U.S. 1, 4, n. 1. The present controversy clearly calls for such a determination by this Court, since the construction given to the statute by the Court of Appeals permits an unconstitutional result.

The Structure of the Statute

Respondent itself shows no such deference for the construction of the statute by the court below, for the main thrust of respondent's statutory argument is not that the Commissioners were empowered to adopt *either* a single-factor or a three-factor formula, as the Court of Appeals held, but that the adoption of *any* other formula than the single-factor sales formula would violate the statute by creating an unauthorized partial exemption of income (Resp. Br. pp. 27-36).[3] This position appears to be based on two grounds: (1) that, irrespective of whether some portion of income from sales to District customers might be determined not to be "fairly attributable" to District business, the tax reaches such amount as "other income . . . derived from sources within the District"; and (2) that Congress expressed its full intention with regard to the exemption of out-of-District corporations in the 1948 amendments to the Act, and any further "exemption" is unauthorized by the statute. We discuss these points in turn.

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[3] The court below, in sustaining respondent's regulations, did not take any such sweeping position, but declared that the three-factor formula (which respondent says creates an unlawful exemption) could be used if the Commissioners chose to adopt it (R. 525-526).

Section 47-1580 of the District of Columbia Code (Pet. Br., App. B, pp. 31a-32a) reads in pertinent part as follows: "The measure of the franchise tax shall be that portion of the net income of the corporation and unincorporated business as is fairly attributable to any trade or business carried on or engaged in within the District and such other net income as is derived from sources within the District. . . ." Respondent repeats (Resp. Br. 33-36) the argument, rejected by the Court of Appeals, that any "portion" of the income from sales to District customers which might be determined, by some formula, not to be "fairly attributable" to District business then falls into the category of "other income", and is taxed by reference to its "source" in the District customer. However, the statute is correctly analyzed by the Court of Appeals in *District of Columbia* v. *Evening Star Newspaper Co.*, 106 U.S. App. D.C. 360, 366-367, 273 F. 2d 95, 101-102, which held that the quoted provision recognizes two separate and mutually exclusive "net incomes", one operating, the other non-operating. *Non-operating* income (dividends, interest, rentals, etc.) is allocated entirely to its "source". *Operating* income, on the other hand (unless the business is carried on entirely within the District), is "deemed to be income *from sources within and without* the District," and "the *portion* thereof subject to tax" is required to be determined by a proper apportionment formula,[4] "depending upon the source or activity which produced it."[5] Respondent would say that the portion of oper-

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[4] D.C. Code 1961, § 47-1580a (Pet. Br. App. B, pp. 32a-33a) (emphasis added).

[5] *District of Columbia* v. *Evening Star Newspaper Co., supra,* 106 U.S. App. D.C. at 367, 273 F. 2d at 102.

ating or business income which is apportioned to "sources . . . *without* the District", is nevertheless taxable as "other income" from sources *within* the District. Such an argument disregards the structure of the statute and renders meaningless the requirement of apportionment.[6]

Respondent also refers (Br. pp. 29-31) to the 1948 amendments to the Income and Franchise Tax Act which were enacted to relieve certain corporations of the burden of filing returns and paying any tax at all if they had no regular business establishment in the District and their District contacts were confined to solicitation and the like. Respondent then argues (Br. pp. 32-34) that any apportionment formula "which would have the effect of exempting" any part of the income realized through sales to District customers, unless embraced within those exemption provisions, "would be at variance with the intent of the Congress." The argument is that because some taxpayers are expressly 100% exempt, others are impliedly 100% taxable. This confuses the question of the reach of the tax with the measure of the tax. The amendments exempted certain corporations but did not alter the *measure* of the tax for those corporations which remained subject

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[6] As respondent acknowledges (Br. pp. 35-36), the court below dismissed respondent's argument in a footnote (R. 512-513, n. 16), referring to its *Evening Star* decision, *supra*, and declaring that respondent's position "would result in an overlap of the two provisions not called for by the taxing scheme." It is true, as respondent points out (Br. p. 36), that the court's view on this issue took nothing from the District, since the entire income in question was held taxable under the "fairly attributable" clause. But if, as petitioner contends, the court below erred on how much is "fairly attributable", the "other income" clause does not make taxable any portion which is properly apportioned to activities outside the District under the "fairly attributable" clause.

to it,[7] which continued to be that *portion* of the net income which is "fairly attributable" to business "carried on" in the District.[8] Excluding the portion not so attributable is exactly what the statute calls for and is in no sense an "exemption".

Legislative History

Respondent (Br. p. 27) also challenges petitioner's statement (Pet. Br. p. 27) that nothing could be found in the legislative history to support the theory of the statute adopted in the Commissioner's regulations. Respondent puts forward the contentions (1) that "an apportionment formula utilizing sales" had been employed under the present and previous revenue acts and had been repeatedly sustained (Resp. Br. pp. 26-27), and (2) that Congress has repeatedly amended the present statute without indicating disapproval of the regulations. Let us examine those contentions (Resp. Br. p. 34).

The first point is essentially the contention which was anticipated and discussed at pages 25-27 of petitioner's opening brief, to which little need be added.[9]

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[7] The situation giving rise to the amendments was precisely analogous to that which prompted Congress, a decade later, to enact Public Law 86-272, 73 Stat. 555 (15 U.S. Code §§ 381-384), after this Court held, in *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, that certain minimal contacts gave the states jurisdiction to levy an apportioned net income tax on local activities of outside concerns. See the Committee Reports on the 1948 amendments, quoted in Resp. Br. pp. 31-32. Respondent's argument would now attribute all of Northwestern States' income to Minnesota, instead of the "fairly apportioned" part approved by this Court, merely because in the meantime Congress has prohibited any tax in some other circumstances.

[8] D. C. Code 1961, §§ 47-1571, 47-1580.

[9] The contention is also answered in the Tax Court's opinion, R. 447-450.

With one exception, the cases cited by respondent involved different statutes and are no authority for interpretation of the Income and Franchise Tax Act of 1947. The exception is *Smoot Sand and Gravel Corp.* v. *District of Columbia,* 104 U.S. App. D.C. 292, 261 F. 2d 758, cert. den., 359 U.S. 968, where the taxpayer's attack on the present regulation failed for an asserted lack of proof that its producing activities contributed anything to its net income. There is no such lack of proof here. A case not cited by respondent is the latest, *Broadcasting Publications, Inc.* v. *District of Columbia,* 114 U.S. App. D.C. 163, 313 F. 2d 554 (discussed at pp. 23-24 of our main brief), which held all the taxpayer's income attributable to its producing activities and none to the locale of its customers.

Panitz v. *District of Columbia,* 74 U.S. App. D.C. 284, 122 F. 2d 61, applied the 1937 Act which imposed a tax not measured by income at all but upon the unapportioned "gross receipts from any business in the District of Columbia". *Eastman Kodak Co.* v. *District of Columbia,* 76 App. D.C. 339, 131 F. 2d 347, construed the 1939 net income tax law and attributed income to the place "where the sale is made". *Electric Storage Battery Co.* v. *District of Columbia,* 81 U.S. App. D.C. 135, 155 F. 2d 867, added that the place where the sale is made is where title passes, a test which Congress later wrote into the statute itself.[10] In *Eastman Kodak,*

[10] Act of June 22, 1942, 56 Stat. 376, ch. 433 (D.C. Code 1961, § 47-1502(b)). In pointing out here and elsewhere (pp. 14, 29, *infra;* Pet. Br. 33-34, 45-48, App. 57a) that the title test and others (other than three-factor formulae) involved in the decided cases would, if applied here, assign almost no income to the District, we are not suggesting that one test is bad merely because another results in less tax. We say that a decision which upholds a test producing very little tax cannot be authority for a different test producing a very large tax.

the Court of Appeals conceded that: "It may be true, as petitioner contends, that from the economic point of view a *large portion* of the income in question is *attributable* to activity which took place outside the District", 131 F. 2d at p. 348 (emphasis added), but it held that fact immaterial *under the 1939 Act.* When Congress changed from an income tax to a franchise tax in 1947, it repudiated the test which had assigned all income to the place of sale and passage of title and, borrowing the language of the Court of Appeals, directed that the tax be measured by the *portion* of net income "fairly *attributable* to any trade or business carried on or engaged in within the District", and added that income derived from business conducted within and without the District "shall be deemed to be income from sources *within* and *without* the District."[11] By that act, Congress completely destroyed the precedent value of the earlier cases.

The second branch of respondent's legislative history argument relies on the fact that the Income and Franchise Tax Act of 1947 has been amended seven times, which is urged as showing assent by silence to the District's apportionment methods. Respondent concedes, however, that none of the changes affected in any way the apportionment of income for franchise tax purposes. In fact, almost all of them dealt with problems peculiar to the income tax on individuals.[12]

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[11] D.C. Code 1961, §§ 47-1580, 1580a (Pet. Br., App. B, pp. 31a-32a) (Emphasis added).

[12] The Act of May 27, 1949, 63 Stat. 129, ch. 146, Title IV, increased individual rates, changed the definition of a resident individual, altered personal exemptions, amended certain provisions relating to deductions, and made other minor changes. The Act of May 18, 1954, 68 Stat. 117, ch. 218, Title XII, raised individual rates. The Act of March 31, 1956, 70 Stat. 70, ch. 154, Title I,

In no instance was there a complete restudy or re-enactment of the statute as a whole, and there is no reason to suppose that Congress, addressing itself to narrow and particular problems, was made aware of the regulation on an entirely different question.[13]

The rule that Congress is presumed to have approved the administrative construction of a statute which it amends or re-enacts without change applies only where "the relevant statutory provision" has been so amended or re-enacted,[14] not where provisions re-

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raised individual rates, altered personal exemptions and the standard deduction for individuals, imposed a requirement of withholding from individual wages, and required a license of certain persons not subject to the unincorporated business tax. The Act of September 4, 1957, 71 Stat. 605, Pub. L. 85-281, provided additional personal exemptions for old age and blindness, exempted Social Security and veterans' benefits from tax, changed the standard deduction, and amended the license provision. The Act of June 27, 1960, 74 Stat. 219, Pub. L. 86-522, did no more than exempt alien employees of international organizations. The Act of March 2, 1962, 76 Stat. 10, Pub. L. 87-408, changed only the due date of the tax.

[13] *Cf. United States* v. *Calamaro*, 354 U.S. 351, 358-359; *Mitchell* v. *Comm'r*, 300 F. 2d 533, 538 (4th Cir.).

[14] *Farmers Educational & Cooperative Union* v. *WDAY, Inc.*, 360 U.S. 525, 532-533 (cited by respondent) ("with full knowledge of the Commission's interpretation Congress has since made significant *additions to that section* without amending it to depart from the Commission's view"); *Allen* v. *Grand Central Aircraft Co.*, 347 U.S. 535, 541, 546 (cited by respondent) (new statute "follows almost word for word the language *of* § *5(a)* of the earlier Act"); *Murphy Oil Co.* v. *Burnet*, 287 U.S. 299, 307 (cited by respondent) (the provisions "*of* § *234(a)(9)* have been re-enacted without substantial change in the Revenue Acts of 1928 and 1932"); *N.L.R.B.* v. *Gullett Gin Co.*, 340 U.S. 361, 366 ("the provision with which we here deal"); *Wilmette Park District* v. *Campbell*, 338 U.S. 411, 417-8 ("the relevant language"); *Crane* v. *Comm'r*, 331 U.S. 1, 7-8 ("the relevant statutory provision"). (Emphasis added in quotations.)

motely connected to it (by being in the same Act) are amended.[15]

The only time respondent's apportionment regulations came to the attention of Congress was in connection with the 1948 amendments. However, if any significance can be attached thereto it supports, rather than weakens, our position. The regulations which were brought to Congress' attention at that time were very different in principle and in detail from those now in controversy. District officials presented and explained the regulations (promulgated November 28, 1947) at hearings before the Joint Subcommittee on Fiscal Affairs of the Committees on the District of Columbia (relevant quotations from which, including the full text of the pertinent regulation, are set out in the Appendix, *infra*). The regulations provided for a rough apportionment by taxing only 50% of the income from a sale if title passed outside the District but the sale resulted from personal solicitation in the District or from a contract or order accepted in the District, and permitting consideration of other factors if sales alone produced an inequitable result. In explanation of those provisions, the Subcommittee was advised that the "intention [was] to allocate and apportion certain portions of the income of the taxpayer within the jurisdiction where the income is earned", as required by *Hans Rees' Sons* v. *North Carolina*, 283 U.S. 123, 131; and that "Because part of that profit was earned by the manufacturer (*sic*) and only part

[15] In *Helvering* v. *Hallock*, 309 U.S. 106, 120-121, n. 7, the reenactment rule was held inapplicable where the specific provision had not been amended or re-enacted, even though other language of the same section had been amended in relation to situations other than the one before the Court.

of it by the sale . . . half of the profit would be allocated to the District of Columbia and half elsewhere.'"[16] Presumably in reliance upon such representations, indicating that interstate sales into the District, by outside concerns with local offices, would not be unduly burdened, the Congress rejected a bill (H.R. 5317) which would have wholly exempted sales in which title passed outside the District, and adopted the Commissioners' substitute which confined the complete exemption to those with no local offices, warehouses or places of business.

In view of this history, we submit that it was the Congressional understanding that the apportionment formula give some weight to the places where the profit was earned and not arbitrarily assign 100% of the profit on all sales to the location of the customer, and that the wide differences between the regulations which were explained to Congress and those applied here deprive of any force the argument that respondent's present position received implied Congressional ap-

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[16] Hearings p. 105 (Appendix, *infra*). The 1947 regulations did not follow that principle consistently, since they taxed 100% of the income if title passed in the District or if delivery was made from stocks in the District, apparently regarding such sales as intrastate transactions involving District source income. Whether or not that aspect of the regulation was impliedly approved by Congress, and whether or not it was violative of due process (Pet. Br. pp. 27-49), is no longer a matter of concern, since the regulations no longer make a distinction based on such considerations. Furthermore, we do not here have sales in which title passed or stocks of goods were maintained in the District (R. 261, 266, 268, 269, 270, 276, 280, 281, 295, 299, 504). Even the 50% rule probably would not have generated any but *de minimis* tax for the District under the facts of this case because petitioner does not ordinarily solicit orders nor accept orders in the District.

proval even in the 1948 amendments, five years before the present regulation was adopted."[17]

2. THE ASSESSMENTS ARE UNCONSTITUTIONAL.

The District Commissioners Are Restrained by the Commerce Clause

In petitioner's brief (p. 49), it was stated that, while Congress itself may have power to impose burdens upon interstate commerce, including commerce between the states and the District, that power "cannot be treated as a mere matter of local concern, and committed to those immediately interested in the affairs of a particular locality." *Stoutenburgh* v. *Hennick*, 129

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[17] In the interim, the regulations went through several permutations, none of which, so far as appears, came to the attention of Congress. On August 31, 1948, the title test was discarded, and sales were required to be taken into account if "*principally secured, negotiated or effected* by owners, employees, officers and branches of the corporation *located* in the District" (emphasis added); a test which excluded sales not effected through some locally based agency. *District of Columbia* v. *Radio Corp. of America*, 98 U.S. App. D.C. 119, 232 F. 2d 376. Still another change was made on March 17, 1953, dropping the word "located" but retaining the requirement that the sales be "principally secured, negotiated or effected" in the District. *Id.*, 98 U.S. App. D.C. at 120, 232 F. 2d at 377. It was not until August 6, 1953 that the Commissioners adopted the test here in controversy, which (as construed by respondent) looks only to the location of the customer, without reference to the presence of any intra-District activity. The validity of that regulation, first in the *Smoot* case, *supra*, and then in this case, and in many cases held to await their outcome, has been in litigation almost ever since. In fact, in *District of Columbia* v. *Gallant, Inc.*, 110 U.S. App. D.C. 202, 290 F. 2d 745, it was held that the August 6, 1953 regulations failed to provide a valid and workable formula at all, and respondent once more tinkered with the regulation on July 14, 1961 (Pet. Br. App. B, pp. 34a-38a). See also *Broadcasting Publications, Inc.* v. *District of Columbia*, 114 U.S. App. D.C. 163, 313 F. 2d 554, which upheld the contention *made by the District* in that case that the location of the taxpayer's customers was irrelevant.

U.S. 141, 148.[18] Respondent argues (Br. pp. 40-41) that *Stoutenburgh* is inapplicable because the then governing body of the District was a legislative assembly instead of the present appointed commissioners. This is a distinction without a difference. The change in the form of government did not change the nature of the District of Columbia, which continued as a *municipal corporation* (D.C. Code 1961, § 1-102;[19] *District of Columbia* v. *Woodbury,* 136 U.S. 450, 452-455; *O'Toole* v. *United States,* 106 F. Supp. 804, 806-807 (D. Del.)) and was not thereby made an administrative department of the national government, sharing its sovereign powers and immunities. *Metropolitan R.R.* v. *District of Columbia,* 132 U.S. 1, 3-9. The District Commissioners have been granted limited legislative powers (see *District of Columbia* v. *John R. Thompson Co., supra,* 346 U.S. 100, 111, 114), including the power in this instance to "amplify" the statute (Resp. Br. p. 40) by prescribing formulas by regulations. Such powers are "legislative in character" (*Ilfeld* v. *Hernandez,* 292 U.S. 62, 65; *Union Electric Co.* v. *United States,* 158 Ct. Cl. 479, 486, 305 F. 2d 850, 853-854) and subject to all the restraints applicable to powers of local legislatures.

Congress itself did not prescribe the use of the single-factor sales formula, with its resultant burden on interstate commerce. The District Commissioners did. While it is undoubtedly true, as the Court of Appeals says (R. 515, 525-6), that the statute gives the Commissioners complete freedom of choice in legislating a

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[18] Cited with approval on this point in *District of Columbia* v. *John R. Thompson Co.,* 346 U.S. 100, 107.

[19] Act of June 11, 1878, 20 Stat. 102, ch. 180, § 1.

formula, exercise of that freedom is subject to constitutional restraints. Municipal officials cannot use their delegated legislative powers in such manner as to burden interstate commerce.

Double Taxation Was Established

Respondent attacks the evidence on double taxation and argues that such proof is irrelevant (Br. 50-54). The record shows that the vehicles sold to District customers had been manufactured largely in Michigan, Maryland and Delaware; the computations and payments of taxes to such states; the statutes of such states; the tax returns there filed; the receipts and cancelled checks for the taxes there paid; and the identification of amounts of income attributed by respondent to such sales (R. 4-5, 13-19).

The printed record contains proof that (R. 4, 377-380):

1) $39,489.72 of the tax assessed for 1957 and $13,655.63 for 1958 was based on Cadillac automobiles manufactured in Michigan;

2) $8,667.01 for 1957 and $17,989.39 for 1958 was based on GMC trucks and coaches manufactured in Michigan;

3) $26,792.99 for 1957 and $10,037.92 for 1958 was based on Buick automobiles assembled in Delaware;

4) $40,590.63 for 1957 and $19,055.71 for 1958 was based on Oldsmobile automobiles assembled in Delaware;

5) $33,835.64 for 1957 and $12,145.79 for 1958 was based on Pontiac automobiles assembled in Delaware;

6) $100,591.40 for 1957 and $55,525.18 for 1958 was based on Chevrolet automobiles and trucks assembled in Maryland;

7) such taxes were computed by applying respondent's tax rate (5%) to 100% of petitioner's net income attributed by the District to the manufacture and sale of such vehicles (*e.g.*, R. 166-167, 172, 211, 214).

Not printed, but in the original record (R. 13-19, 125-126; Exhibits 9-21):

8) Michigan, Delaware and Maryland impose income-based taxes, apportioning income by three-factor formulae of property, payroll and sales (Pet. Br., App. B, pp. 38a-48a);

9) petitioner was required to and did pay to such states taxes so computed, in the amounts of $8,955,799.55 to Michigan and $510,792.31 to Maryland in 1957, and $6,940,309.50 to Michigan, $127,844.95 to Delaware and $271,425.25 to Maryland in 1958;

10) of the amounts so paid, a portion as shown on each return was based upon income attributed to the employment of property (principally the factories at which the vehicles sold to District customers were manufactured) in the respective states, a portion upon income attributed to the payroll (principally labor at those factories) in the respective states, and a portion (irrelevant here) upon income attributed to sales made to customers in the respective states. (Exhibits 9-21.)

What petitioner did not show is the portion of each tax payment to Michigan, Maryland and Delaware which was attributed to vehicles sold to District customers. In each instance, one more figure would have shown that: the total sales of the products of the re-

spective factory in the respective year. We know, for example, that Chevrolet had 1957 receipts from sales to District customers of $14,506,832 (R. 377). If we knew the total sales of Chevrolet's Maryland plant, we could apply a fraction to the known Maryland tax attributable to property and payroll and obtain a figure accurately representing the amount of tax paid to Maryland with respect to Chevrolet vehicles sold to District customers.

Unless the result of that computation were *de minimis*, and it certainly is not, its size is irrelevant. It is shown that Maryland taxed a very substantial portion of the income derived from the manufacture of every vehicle assembled at the Maryland factory, including those sold to District customers. Whether of the total Maryland tax of $510,792.31 the amount paid with respect to vehicles sold to District customers was $50,000 or $100,000 or $150,000 is irrelevant to the *fact* of double taxation and the constitutional invalidity of a formula designed to achieve it.

Actually, as demonstrated in our main brief (p. 52), the double taxation clearly appears from a comparison of the formulae themselves. When it is shown that the state in which production occurs attributes two-thirds of income to the factors of production, and the state of destination attributes all income to destination, the proof is complete.

The argument on p. 54 of respondent's brief—that we do not know the amount of income derived from that segment of petitioner's business culminating in sales to District customers—is circular. The computation complained of is respondent's own computation. That it reached 100% of the income from that segment of the business is obvious on the face of the computa-

tion and is supported by the testimony of all the experts, including those offered by respondent. Pet. Br. 15-22; R. 166-167, 172, 211, 214. The contention is, in effect, that separate accounting must be used, a contention which is unsound. *Butler Bros.* v. *McColgan*, 315 U.S. 501; Pet. Br. 38-40.

Based upon the foregoing, the Tax Court found double taxation *as a fact:*

Finding 3(b) (Pet. Br. App. 2a, R. 495):

> "A portion of the net income of petitioner derived from the segment of petitioner's business consisting of the manufacture of products without, and sale within the District of Columbia was taxed by the above mentioned states, pursuant to apportionment formulas (with factors of property, payroll and sales), as provided by their laws."

Finding 6 (Pet. Br. App. 3a, R. 496):

> "The method used by the assessing authority of the District attributed to the District 100 per centum of the net income derived by the petitioner from that segment of its business which consisted of the manufacture without, and the sale of products within the District."

It is obvious that such findings are fully supported by the evidence. Nothing more is required.

Respondent (Br. 53) wonders why only the District, and not the other states, is wrong. Respondent's witnesses, attempting to justify the District's single-factor destination-sales formula, pointed out that, if every jurisdiction used that same formula, 100% of petitioner's income, and only 100%, would be divided among the several jurisdictions and taxed (R. 134, 193, 198). *Any* formula, consistently and universally

applied, will achieve one of the ideals of a formula: it will divide up the taxpayer's entire income without either duplication or omission. But if it is, as this one is, a wholly irrational formula, unrelated to actual values, income-producing factors, and costs of governmental services, it will result in depriving some states of their rightful revenues while permitting others to reach beyond their territories to take what does not belong to them. Michigan, Maryland and Delaware have quite properly taken the position that petitioner should pay taxes to them for services rendered to the plants and personnel within their borders. They cannot be expected to agree to forego all tax on that portion of the business culminating in sales to District customers merely because the District assigns it all to itself. The District must recede to a fair share.[20]

Excessive Taxation Was Established

Respondent bases its attack on our proof of excessive taxation primarily upon characterizations, with which we disagree, of the expert testimony and the Tax Court's findings of fact. (Resp. Br. 19-21, 55-64.) An attempt is made to weaken the testimony of petitioner's experts by asserting they disagree with each other. Not so, on any material point.

There was no disagreement whatever among petitioner's experts that income arises solely from the factors of production, that such factors can be measured by costs, that property and payroll are the most prac-

[20] The District does not consistently follow any formula, selecting in each case the rationalization which produces the most tax. See our main brief, pp. 23-24, contrasting this case with *Broadcasting Publications, Inc.* v. *District of Columbia*, 313 F. 2d 554.

tical indicators of costs, that sales as such have nothing to do with it, that the District's formula attributed 100% of relevant income to the District, and that such attribution is unreasonable. See petitioner's brief, pages 41-43, for record references and analysis. Professor Morton added that it would not be unreasonable, theoretically, to assign certain costs, such as advertising, to the place where they take effect rather than where incurred—i.e., to the point of sale (R. 229-230). The items to which the point relates are relatively so small that the complication of dealing with them separately could not be justified by the change in results. Professor Paton and Mr. Powell conceded that, to the extent that activities occurred at the location of customers, a sales factor did no harm, being merely duplication (R. 40, 42-43, 77, 84), whereas Professor Studenski, pointing out that such activities were measured by property and payroll, could not approve a sales factor at all (R. 94, 97-98). Such minor differences detract nothing from the force of the unanimity on fundamentals—especially since there is no issue between the parties as to whether a sales factor should be used. The issue in the case is whether sales may be used alone, or whether it must be in conjunction with factors measuring the contribution of production.

Each of respondent's experts started out by responding "yes" to a hypothetical question as to whether the single-factor sales formula reasonably determined the income "fairly attributable" to the District (R. 129, 164, 189-190). When pressed on cross-examination, all conceded that manufacturing and other activities, as reflected in costs, were "one of the causes" of net income (along with, they said, the "activities" of the customers) (R. 171-175, 179, 194, 199-202, 204), al-

though one—Dean Baily—sought to avoid the obvious by a monumental quibble. He insisted that net income is not "attributable to" or "created" or "caused by" or "due to" those activities (R. 135-149), but that income is "created by the act of sale" (R. 142-143, 146, 148), although he had to recognize that those other activities "made possible" the product (R. 142-143, 147-148), without which he agreed there could be no sale and no income (R. 142, 148, 157-158). It is, he said, like a "three-legged stool . . . if you pull any one of them away . . ." (R. 145).

Professor Watson started out confidently but became embarrassed when he discovered the issue in the case. He explained his answer to the hypothetical by stating that every dollar of sales may reasonably be assumed to contain the same profit element as every other dollar of sales (R. 166, 172). Thus, he had answered the hypothetical as if it had been whether the single-factor sales formula reasonably determined the income "fairly attributable" to the products sold to District customers, which is quite different from income "fairly attributable" to the District. He said that capital and labor together with customer acceptance are "causes of net income" (R. 171), and that the income from products sold to District customers could not be attributed solely to activities in the District (R. 173). The sales factor alone, since it would attribute 100% of the relevant income to the District, would not comply with the statutory requirement that such income be deemed to be from sources within and without the District (R. 185).

Mr. Nathan stated that there were many factors in the production of income, and that the District's formula, in taxing 100% of the relevant income, did not

comply with the statute (R. 202, 206-207). He thought it was "fair" for the District to do that because the District has very little taxable industry of its own (R. 199). Asked if he did not think it unfair to assign to the District (and to other customer locations) all the income earned by the factories in Michigan to the deprivation of the latter state, he replied that Michigan could tax the businesses which sold to petitioner and its employes (R. 193).

Thus it appears, not only that petitioner's experts were in complete agreement on all essentials, but that respondent's witnesses agreed also on enough of them to establish the invalidity of the District's assessments.

Contrary to respondent's repeated assertions (Br. 20, 23, 59, 62, 64), the Tax Court based controlling findings on the expert testimony. The Tax Court recognized the error in section VI of its original opinion, struck that section (see revised opinion Pet. Br. App. 1a-29a, R. 495-497), and based at least these findings on such evidence:

> "The segment of petitioner's business which was conducted both within and without the District of Columbia consisted of the manufacture of a certain number of automobiles and kindred products without the District and the sale thereof to customers within the District. The net income from this segment of petitioner's business was earned by a series of transactions beginning with the manufacture of products in several states and ending with the sale to customers within the District. While the net income was not realized until sale, it was earned in part by manufacture of the products sold, including in addition to actual manufacture, procurement of material, financing, use of property and administration." (Finding 5, Pet. Br. App. 3a; R. 495.)

> "The method used by the assessing authority of the District attributed to the District 100 per centum of the net income derived by the petitioner from that segment of its business which consisted of the manufacture without, and sale of products within the District. The percentage thus determined was out of all reasonable proportion to the trade or business carried on or engaged in by petitioner within the District." (Pet. Br. App. 3a; R. 496.)

From the recitals above, it is immediately apparent that these findings are an almost perfect synthesis of the testimony of *all* the experts.[21]

Respondent attempts (Br. 55-59) to make something of the fact that the Tax Court added findings 3(b), 5

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[21] Petitioner's witnesses on one hand and respondent's on the other answered in opposite ways the hypothetical question—does the single factor of destination of sales measure income "fairly attributable" to the District. That disagreement was more apparent than real, as analysis shows, and to the extent it remains rests upon the untenable premises of respondent's witnesses (*e.g.*, that net income arises from sales alone, and not to any extent from manufacturing), from which they all retreated upon cross examination. Such premises are wrong in law as well as in fact, this Court having repeatedly stated that income is "derived from capital, labor or both combined", *Stratton's Independence* v. *Howbert*, 231 U.S. 399, 415, and there is no support "for the conclusion that when a corporation manufactures in one State and sells in another, the net profits of the entire transaction, in a unitary enterprise, may be attributed, regardless of evidence, to either State", because "all the factors of that enterprise are essential to the realization of profits". *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123, 132-133. The Tax Court properly resolved the differences in its findings. ". . . [I]t is the very essence of the trial court's function to choose from among the conflicting and competing inferences and conclusions that which it deems most reasonable . . . . Where, as here, the question turns largely on the testimony of experts, the trial court has the right to decide which set of experts . . . will be credited . . ." *Evans* v. *United States*, 319 F. 2d 751, 755 (1st Cir. 1963).

and 6, and struck out the portion of its opinion criticizing all the expert testimony, on motion of petitioner after the Court's original opinion had been filed. Actually, this strengthens those findings, since it demonstrates that they were very carefully reconsidered. Since they relate primarily to the constitutional questions, it is understandable that the Court, which did not consider these questions, overlooked the related findings in the first instance. The Tax Court said for instance:

> "The Court will add findings of fact 5 and 6, but not verbatim as asked in portion 'II' of petitioner's motion, but as the Court believes they should be stated *and as should have been made in the original findings of fact.*" (R. 492.) (Emphasis added.)

The thrust of respondent's argument under section IV of its Brief (pp. 55-64), as well as in the final passage of section III (p. 54) is that it is impossible to apportion income with ultimate precision, and thus whatever formula is applied, a taxpayer cannot prove that the income attribution is unreasonable and arbitrary, leaving the respondent's determination as final. This Court, in *Hans Rees' Sons, Inc.* v. *North Carolina,* 283 U.S. 123, 134-135, flatly rejected any such argument, declaring that it was not necessary "to determine as a matter of fact the precise part of the income which should be regarded as attributable to the business conducted in North Carolina" in order to determine that the amount taxed was excessive. To demand such precision is to make every formula immune to attack since resort to formulas is justified on the ground that absolute precision is impossible. See petitioner's brief, pp. 38-41. Respondent's argument

here is one often advanced by those determined to uphold arbitrary assessments regardless of evidence: since precision is impossible, the assessments are not subject to attack by showing (even gross) inaccuracies; but the taxpayer's demonstration is irrelevant because it is imprecise.

By the best measures available, the District has taxed eleven times the income derived from petitioner's District business activities (Pet. Br. p. 43). No conceivable degree of imprecision could dislodge that enormous disparity. Suppose it were only ten times, or six, or four and a half as in *Hans Rees'*?

Petitioner recognizes that it has the burden of proving excessive taxation and has done so. It has not, as respondent suggests (Br. p. 58), merely shown that different apportionment formulas would produce a different tax effect. It showed the source of its income in its activities almost all outside the District; it showed the best measures of the relative contributions of activities within and without the District; it showed that respondent's method had no tendency at all to find and measure the source; and it showed that, in this case, there was not even a coincidence between respondent's attribution and petitioner's acceptably accurate computations.

A Valid Formula Must Recognize the Contribution of Activities Outside the Jurisdiction

Respondent's points that petitioner's activities outside the District are of no concern to the District (Resp. Br. 37), and that location of factories is irrelevant because the District is not taxing factory locations (Resp. Br. 47), make no point at all. The problem is to find a measure of the income attributable to

activities in the District. Since that has to be done by fractions, with District figures in the numerators, the outside factors must be included in the denominators.

Respondent in this argument is apparently trying to assimilate the District's net income-based tax to a gross receipts tax, since it cites *General Motors Corporation* v. *Washington*, 377 U.S. 436 (Resp. Br. 38). The tax there involved was imposed on gross receipts of transactions having local incidents. It had nothing to do with determination of where net income arises or with apportioning net income for the purposes of a tax based on net income. It has long been established that taxes measured by gross receipts, like sales and use taxes, may be imposed upon transactions having local incidents. *Norton Co.* v. *Department of Revenue*, 340 U.S. 534. *General Motors Corporation* v. *Washington* merely broadened the definition of "local incidents" within that rule.

In contrast, a net income-based tax is not in any sense a transaction tax, but, being imposed upon or measured by net income, depends for its validity upon the locale of the derivation of the income. It has been the uniform position of this Court, from *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113, through *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 462-463, that such a tax satisfies due process if, and only if, it is so *apportioned* that it "reached, and was meant to reach" only "that portion of taxpayer's net income which arises from its activities within the taxing state", *i.e.*, "the profits earned by the processes conducted within its borders."[22]

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[22] The quotations are from *Underwood*, *supra*, 254 U.S. at 121, and *Northwestern States*, *supra*, 358 U.S. at 464. To like effect, see *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123, 132-134.

The gross receipts tax in *General Motors* v. *Washington, supra,* was acknowledged by the majority of this Court to be an *unapportioned* tax (377 U.S. at 448); that is, all the gross receipts from every sale transaction within the state were taxed, without regard to the locale of the commercial activity producing the products sold.[23] By the same reasoning, a tax the effect of which is to attribute to the District all the *net profits* derived from activities culminating in sales to District customers is unapportioned. Thus, the court below erred in its view (R. 511-517) that the present formula, by merely dividing sales geographically, accomplished an apportionment of the net income. See Pet. Br. pp. 23, 35. Washington did not tax sales to customers outside the state, either.

Respondent contends (Br. 45) that "this Court has sustained the use of similar single-factor formulas inherently comparable to that adopted by the Commissioners of the District of Columbia." It has been demonstrated at pp. 33-34, 45-48 and App. F, p. 57a, of petitioner's opening brief that the decisions cited and the formulas involved therein are not at all comparable and would, in fact, if applied here produce very little if any tax for the District. We have found no decision of this Court or of any other jurisdiction which sustains an apportionment of net income by a ratio which, like respondent's formula, looks only to the destination of sale and takes no account whatever of the locale of the activities by which the income is produced.

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[23] As Mr. Justice Brennan pointed out in dissent, an "apportionment" contemplates consideration of "the commercial activity within the State, and not the sales volume" (377 U.S. at 450-451). The majority did not disagree with his concept of an apportionment, but only with its necessity in the case of a gross receipts tax on transactions having local incidents.

Respondent states (Br. 45) that "the District is not alone in apportioning income on the basis of a sales factor formula." The tabulation on page 119 of the Congressional study, which respondent cites, shows four jurisdictions as using the single factor of sale, but only three can be identified in the more detailed breakdown at pages 116-117 thereof. In addition to the District, they are Iowa and Missouri. In practice, however, those states have been able to confine the tax base to net income reasonably related to in-state activity, and hence no litigation on the validity of their formulas appears to have developed. The statutory formula in Iowa is based on sales of goods "sold and delivered within the State", and not on customer situs as in respondent's destination sales formula.[24] The Missouri statute is based on 100% of intrastate sales and 50% of interstate sales[25] (as were the District's November 28, 1947 regulations, discussed at pp. 13-14, *supra*). Both the Iowa and Missouri laws expressly prescribe that, where the sales formula is inequitable, different methods are permissible.[26] In practice, Missouri, at least, freely allows a manufacturer to use the generally accepted formula of property, payroll and sales.[27]

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[24] Iowa Code Ann. § 422.31(1). It is clear from the regulations thereunder that only certain *intrastate* sales are included in the numerator of the formula, which thus has some tendency to limit the tax to local activity. CCH Iowa Tax Rep. ¶ 12-432 (pp. 1201-1202).

[25] Mo. Rev. Stat. § 143.040.

[26] Iowa Code Ann. § 422.33(2); Mo. Rev. Stat. §§ 143.040(2), 143.080.

[27] CCH Mo. Tax Rep. § 11-505 (pp. 1244-1245), ¶ 11-515 (p. 1252).

In its insistence upon the single factor of destination of sales, therefore, the District stands quite alone.

Respondent says (p. 58): "Unless the fact of manufacturing is of such importance as to require that any formula for the apportionment of General Motors' income must include factors which will, in some manner, weigh manufacturing, the District's formula . . . is not subject to rejection . . ." We are glad to accept that challenge, and to rely upon the established fact, as well as common sense, of the "unless" clause word for word. *Since* any formula for the apportionment of a manufacturer's income *must* include factors which will weigh (or at least coincide with) manufacturing, the District's formula *must* be rejected.[28]

While there may be differences of opinion on details of the factors, and their content, in any apportionment formula, it seems obvious, and the record conclusively proves, that the major portion of a manufacturer's net income finds its "source" in, and is "fairly attributable" to, those jurisdictions in which it carries on its production activities. The fact that an absolutely precise determination is impossible does not excuse the application of a destination sales formula which makes no attempt at all to measure income-producing activities and assigns 100% of the income to the location of the customer, regardless of where the taxpayer's activities are carried on, and thereby pro-

[28] In this same sentence respondent refers to the District's formula as being "based . . . upon General Motors' 'trade or business' in the District." This assumes that sales to District customers are "trade or business" in the District. Even if such an assumption were correct, it does not comport with the statutory (and constitutional) requirement that income be apportioned to "trade or business *carried on or engaged in* within the District"—*i.e.*, to activities within the District.

duces a result "out of all reasonable proportion to the trade or business carried on" at the customer location. The Tax Court's formula is consistent with the statute, recognizes the contribution of manufacturing to petitioner's income, and makes a fair apportionment.

CONCLUSION

The Tax Court found that the assessments failed to limit the measure of the tax to the portion of petitioner's income fairly attributable to business done in the District, as required by the statute. The Tax Court also found as a fact, based on "a record which overwhelmingly sustains the Tax Court's findings",[29] that the tax was "out of all reasonable proportion to the trade or business carried on or engaged in by petitioner within the District"—a finding which, if it had been necessary to reach the constitutional issue, would have compelled the conclusion that the tax was unconstitutionally imposed. The double taxation, which was another fact found by the Tax Court, was clearly attributable to the District's unreasonable "formula", which thus imposed an unconstitutional burden upon interstate commerce. Nothing in the decision of the Court of Appeals or in respondent's brief effectively refutes the Tax Court's conclusions.

In the absence of a valid and applicable apportionment formula prescribed by regulations, it was the power and duty of the Tax Court, exercising its discretion as an administrative agency,[30] to "determine

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[29] Dissent of Judges Danaher, Miller and Bastian in the court below (R. 528-530).

[30] See *District of Columbia* v. *Brady*, 109 U.S. App. D.C. 324, 326, 288 F. 2d 108, 110.

the amount of the net income which is fairly attributable to the District . . . by use of such formula as the Tax Court deems best suited for determination of that question in this case." *District of Columbia* v. *Gallant, Inc.*, 110 U.S. App. D.C. 202, 205, 290 F. 2d 745, 748.[31] The formula which it found "best suited" was one which has had wide acceptance among the states and which is recognized as meeting constitutional standards by providing a reasonable and fair measure of the net income which arises from activities within the taxing state.

The Tax Court's action was in all respects proper and should be sustained. The judgment of the Court of Appeals should be reversed and the decisions of the Tax Court reinstated.

Respectfully submitted,

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[31] See also *District of Columbia* v. *Gallant, Inc.*, 113 U.S. App. D.C. 92, 305 F. 2d 761 (second appeal); *District of Columbia* v. *Southern Railway Co.*, 107 U.S. App. D.C. 285, 277 F. 2d 84. See D.C. Code 1961, § 47-2403.

APPENDIX

Hearings Before the Joint Subcommittee on Fiscal Affairs of the Committees on the District of Columbia, Congress of the United States, Eightieth Congress, Second Session, on Methods of Acquiring Additional Revenue through Taxes and Other Means (March 18 - May 13, 1948)

Testimony of Vernon E. West, Corporation Counsel, and George C. Updegraff, Assistant Corporation Counsel (pp. 103-105)

Mr. Updegraff. Well sir, I will have to elaborate a little further on that, on the subject of apportionment.

Under the various income tax laws throughout the States, there have been devised systems of allocation and apportionment of income. The reason for that is this: If the State has the power to impose a tax, then the question is: What part of the income of any corporation or individual has its source within the taxing jurisdiction?

So that if the business is separately conducted within that jurisdiction, there is no trouble. That is what is termed "separate accounting," for example.

But if the business is a unitary business, which must depend upon activities in various jurisdictions, then the question of apportionment arises, and you must have a formula.

What goes into the formula is more or less left up to the taxing jurisdiction.

Now, some States have various factors. Some States only have one. In the District of Columbia, under the apportionment formula, the principal and, I should say, sole formula used with respect to unitary businesses was the sales factor. There are other factors, such as manufacturing costs, the value of property used in the business, the amount of pay rolls, and the cost of sales.

Well, there is very little if any manufacturing done in the District of Columbia. Most of the business is derived from sales. So there is a good reason for using the sales factor.

If that factor is unsatisfactory, under both the apportionment formula of the 1939 act and under the 1947 act, the taxpayer can come in and show to the assessor that the amount apportioned or allocated to the District of Columbia is unfair, and he will use different factors, or he will even use a separate accounting method if the taxpayer can show that he is entitled to such a method of computing the income.

Senator Cain. Let us use that Baltimore firm, just as a case. Would it be your habit and that of the District officials, to sit down with whoever the proper authority or official was within that Baltimore concern and say, "Look, let us try to figure out what proportion of your business is actually done within the District of Columbia, and we will pay you accordingly"?

Or did you just send them a bill for taxes as a result of the District's own determination, and then, if the business being taxed took exception to the proportion being assessed against them, have them come over to the District and sit down and try to iron out whatever the differences may have been?

Mr. Updegraff. I don't recall. I don't know what the actual fact was with respect to the administrative proceeding before the assessor; but I do know that under the regulations in the formula then in effect, the taxpayer had the right to do just that.

Senator Cain. I am just troubled in my own mind about how this thing works in a practical sense. I understand your position. It is understandable. You think that every out-of-city corporation doing business ought to be charged for that proportion of its business which is done within the

District. But I should think on the basis of this apportionment, ther would be hundreds of businesses having their domicile o side the District and doing business in the District, a ut which the District officials would not know anything.

And so, you would necessarily be taxing some people whom you knew were doing business; but as to others who were conducting a lot of business by mail, how would you figure that out?

Mr. Updegraff. May I elaborate on that a little bit, Mr. Chairman?

Senator Cain. Well, please. And I trust you do not take exception to any of these questions, because we are merely trying to understand an unusual situation.

Mr. Updegraff. Not at all.

With respect to the apportionment of income, the intention is to allocate and apportion certain portions of the income of the taxpayer within the jurisdiction where the income is earned.

Now, it may be a certain percentage in one State and a larger percentage in another; as it was in the case known as the *Hans Rees case,* a North Carolina case, reported in 283 United States Reports. That case involved a leather manufacturer who had its principal plant in North Carolina and had a warehouse in New York City and did business all over the world and throughout every State in the Union.

The North Carolina tax under the allocation and apportionment theory was based solely on the property factor; 89 percent of the income, as I recall. The Supreme Court said it was unreasonable. And the court said that the other jurisdictions were entitled to more of a portion. In other words, North Carolina got more than fair share. And the court said that the allocation and apportionment formula used in that case was unreasonable.

That is *Hans Rees Incorporated* v. *North Carolina* (283 U.S. 123), at 131.

Then there is the question of: What is "doing business"?

Mr. West. Before you get off of that, I think I can clarify this and I think I am correct in my statement: If for example, a company sells goods in the District of Columbia manufactured outside of the District of Columbia, from which it makes a net profit of $100,000, let us say, we don't treat that whole $100,000 profit as being taxable in the District of Columbia. Because part of that profit was earned by the manufacturer, and only part of it by the sale.

So under our system or formula, half of the profit would be allocated to the District of Columbia and half elsewhere.

Is that not correct, Mr. Updegraff?

Mr. Updegraff. That is correct.

Regulation of November 28, 1947, placed in the record of the hearings at pp. 117-118

GOVERNMENT OF THE DISTRICT OF COLUMBIA,
EXECUTIVE OFFICES,
Washington 4, D. C., November 28, 1947

Ordered

That regulations pertaining to income and franchise taxes promulgated August 28, 1947, under authority of title XVI, article I, of the District of Columbia Revenue Act of 1947 (Public Law No. 195, 80th Cong.), approved July 16, 1947, are hereby amended as follows:

Add to section 10-2(d), subsection (1), the following subsections:

"a. Income derived from the sale of tangible personal property shall be deemed to be income from sources within the District where title to the property sold passes from

the seller to the purchaser within the District. Title passes within the District when the goods are shipped in any manner whereby title is retained in the seller until the goods are delivered within the District; ordinarily, such is the case when goods are shipped into the District (a) C.O.D.; (b) on bill of lading with draft attached; (c) under an installment or conditional sales contract; (d) consigned to the seller or its agent; (e) to a warehouse for delivery therefrom; (f) in delivery equipment of seller; (g) by contract carrier employed by seller; (h) f.o.b. Washington, D. C.; (i) freight or other cost of transportation paid by seller; (j) where the consignee assumes no obligation to purchase goods until resold by him or until sometime subsequent to their receipt by him. There may be cases where the seller and buyer arrange for shipment of goods into the District in a manner inconsistent with one or more of the foregoing examples, such as where a seller ships the goods f.o.b. a point outside the District but pays the freight or cost of transportation to the buyer in the District. In such cases the agreement between the parties governs as to the place where title passes to the goods sold. If a taxpayer claims that title to the goods sold passes outside the District under the terms of an agreement, a copy of such agreement (if in writing) must be furnished to the Assessor with the return, together with typical forms used in making shipments.

"b. The total income derived from all sales made in such a manner that title to the goods sold passed within the District from the seller to the buyer is income from sources within the District, regardless of whether the seller was or was not engaged in business within the District during the taxable year.

"c. The percentages appearing in the following table show what part of the total gross income derived from sales made under the various circumstances stated therein is deemed to be fairly attributable to business carried on

or engaged in within the District and gross income from District sources and is therefore subject to the tax. In order that the taxable gross income to be reported in the return of the corporation may be computed correspondingly there shall be included in the numerator of the fraction in the apportionment formula 50 percent or 100 percent, whichever is indicated in the table as appropriate, of the total amount of sales made under each of the classes of circumstances listed below:

"(A) Where the sale was of goods delivered from stock located in the District:

(1) to the buyer in the District, 100 percent;

(2) to the buyer outside the District—

(a) and title to the goods sold passed within the District from the seller to the buyer, 100 percent.

(b) and title to the goods sold passed outside the District from the seller to the buyer and if the sale resulted from personal solicitation made by the seller or his agent in the District and/or the order for the goods or the contract of sale (written or unwritten) was accepted in the District, 50 percent.

"(B) Where the sale was of goods delivered from stock located outside the District:

(1) to the buyer in the District in such manner that title to the goods sold passed in the District from the seller to the buyer, 100 percent.

(2) to the buyer in the District and title to the goods sold passed outside the District from the seller to the buyer and if the sale resulted from personal solicitation made by the seller or his agent in the District in the course of a trade or business en-

gaged in or carried on within the District and/or the order for the goods or the contract of sale (written or unwritten) was accepted in the District in the course of a trade or business engaged in or carried on within the District, 50 percent."

By order of the Board of Commissioners, District of Columbia.

G. M. THORNETT
Secretary of the Board.